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DUE-ON-SALE CLAUSES IN MINNESOTA: THE APPLICATION OF THE GARN ACT AFTER *VIERECK v. PEOPLES SAVINGS & LOAN ASSOCIATION*

Since the Depression of the 1930's, lending institutions have routinely included due-on-sale clauses in their mortgage instruments to protect their security interests. In recent years, issues of federal preemption have generated a great deal of confussion regarding the enforceability of due-on-sale clauses. In Viereck v. Peoples Savings & Loan Association, *the Minnesota Supreme Court added to this confusion. This Note thoroughly discusses the legislation and case law in this area and analyzes the effect of* Viereck *on the Minnesota real estate market.*

I. INTRODUCTION

In January 1984, the Minnesota Supreme Court decided *Viereck v. Peoples Savings & Loan Association.*[1] *Viereck* drastically affects transfers of real estate in Minnesota until October, 1985. The court held that the Garn-

1. 343 N.W.2d 30 (Minn. 1984).

St. Germain Depository Institutions Act of 1982[2] (Garn Act), which permits the acceleration of due-on-sale clauses with a few exceptions, does not apply retroactively to Minnesota mortgages executed prior to June 1, 1979.[3] The court also held that federal law does not preempt Minnesota law governing conventional real estate mortgage due-on-sale clauses executed before June 1, 1979, even where the original state-chartered mortgagee subsequently acquired a federal charter or assigned the mortgage to a federally-chartered savings and loan association.[4] Therefore, under *Viereck,* a lender holding a conventional mortgage, executed or transferred before June 1, 1979 on a borrower-occupied home, may not accelerate payment or charge a higher interest rate when the home is sold unless it is necessary to protect the mortgagee's security interest.[5] This result is surprising in view of the broad preemptive effect of the Garn Act.[6] *Viereck* may stand for the Minnesota Supreme Court's attempt to salvage pro-consumer mortgage law in the face of the pro-lender stance of the Garn Act and the Federal Home Loan Bank Board regulations promulgated pursuant to the Act.

The *Viereck* decision and its interpretation of the Garn Act cannot be viewed in a vacuum. Accordingly, this Note shall approach the *Viereck* decision by tracing the history of the due-on-sale clause from its early origins through the litigation of the 1960's and 1970's which culminated in the United States Supreme Court's decision in *Fidelity Federal Savings & Loan Association v. de la Cuesta.*[7] This Note examines the Garn Act, its legislative history, and the initial confusion this legislation caused in Minnesota. It then turns to the regulations implemented by the Bank Board in 1983 and analyzes their pro-mortgagee effect in Minnesota. The Note concludes with an analysis of the *Viereck* decision against this background.

II. THE DUE-ON-SALE CLAUSE

A. Early Origins

The due-on-sale clause is an acceleration clause commonly used in mortgage instruments.[8] It allows the mortgagee to accelerate the matur-

2. Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 (1982). The portions of the Garn Act applicable to this Note are codified as amended at 12 U.S.C.A. § 1701j-3 (West Supp. 1983).

3. *Viereck,* 343 N.W.2d at 34-35; *see infra* note 275 and accompanying text. The *Viereck* court also held that state-chartered lenders may not circumvent state restrictions by selling mortgages to federal savings and loan associations or by acquiring a federal charter. *Id.* at 34; *see infra* note 277 and accompanying text.

4. *See id.*

5. *See id.* at 34-35.

6. *See* 12 U.S.C.A. § 1701j-3(a)(1) (West Supp. 1983).

7. 458 U.S. 141 (1982).

8. Thornburg, *The Due-On-Sale Clause: Current Legislative Actions and Probable Trends,* 9

ity of the loan upon the sale or alienation of the real property securing the loan.[9] Lending institutions across the United States include due-on-sale clauses in their mortgages to protect their security interests.[10]

1. History of the Due-On-Sale Clause

In the United States, the validity of the due-on-sale clause was first addressed[11] in 1898 in *Board of Church Erection Fund v. First Presbyterian Church of Seattle.*[12] In *Board of Church Erection Fund,* the plaintiff financed the construction of the defendant's church.[13] The parties' agreement contained an acceleration clause calling for payment of the total principal if the church was sold or abandoned, or ceased being used as a house of worship.[14] The Washington Supreme Court held that the clause was a reasonable restraint on alienation and therefore enforceable.[15]

FLA. ST. U.L. REV. 645, 646 (1981). *See* Holiday Acres No. 3 v. Midwest Fed. Sav. & Loan Ass'n, 308 N.W.2d 471, 480 (Minn. 1981). According to the *Holiday Acres* court,

> A due-on-sale clause is a mortgage payment acceleration clause which requires the borrower to obtain the consent of the lender prior to the disposition of the borrower's interest and which permits the lender, by exercising its option to deny consent, to declare the entire balance due and owing.

Holiday Acres, 308 N.W.2d at 480.

9. *See* G. OSBORNE, G. NELSON & D. WHITMAN, REAL ESTATE FINANCE LAW 295 (1979). An acceleration clause empowers the lender to declare the whole amount of the mortgage debt due and payable in the event of a default by the borrower. Such defaults include failure to pay installments on the note, failure to pay taxes, failure to maintain insurance, and failure to keep the property in repair. *Id.* at 435. Other events, such as the borrower's failure to pay public assessments, may give rise to acceleration by the lender if provided for in the contract. *See* Note, *Mortgages—A Catalogue and Critique on the Role of Equity in the Enforcement of Modern-Day "Due-On-Sale" Clauses,* 26 ARK. L. REV. 485, 485 (1973).

Without a due-on-sale clause in financing documents, the mortgagee could not accelerate the debt upon sale. *See* Young v. Hawks, 624 P.2d 235, 237 (Wyo. 1981) (improper to imply a due-on-sale clause where none exists in mortgage agreement).

10. Casenote, *Mortgages: Due-On-Sale Clause, Restraint on Alienation—Enforceability,* 28 CASE W. RES. 493, 503 (1978). "In 1970, the Federal Home Loan Mortgage Corporation conducted a survey of conventional mortgages . . . and found that over two-thirds of such mortgages included due-on-sale clauses." *Id.* at 503 n.1.

11. While the due-on-sale clause currently enjoys widespread use, legal scholars have been unable to document its advent in English law. ABA Committee on Real Estate Financing, *Enforcement of Due-on-Transfer Clauses,* 13 REAL PROP. PROB. & TR. J. 891, 893 (1978). Under feudal law, "a pure and genuine feud could not be transferred from one feudatory to another without the consent of the lord; lest thereby a feeble or suspicious tenant might have been substituted and imposed upon him to perform the feudal services." 2 W. BLACKSTONE, COMMENTARIES *287. These restrictions were in general removed by the Statute of Quia Emptores Terrarum, 18 Edw. I, ch. 1 (1290), which codified the doctrine prohibiting restraints on the alienation of real property. *See* 47 MISS. L.J. 331, 333 (1976).

12. 19 Wash. 455, 53 P. 671 (1898).

13. *Id.* at 458, 53 P. at 672.

14. *Id.*

15. *Id.* at 461, 53 P. at 673. The court concluded that:

> The mortgagors are not prevented from selling the property. No restrictions are

In another early due-on-sale case, *Tidwell v. Wittmeier,*[16] the Alabama Supreme Court considered the validity of a due-on-sale clause. In *Tidwell,* the mortgage provided that all the installment payments would become due when the mortgagor sold the land.[17] The court held that the clause was enforceable under a plain language interpretation of the mortgage.[18] This paucity of early case law can be attributed to the general absence of due-on-sale clauses in mortgage instruments prior to the 1930's.[19]

2. *The Due-On-Encumbrance Clause*

Another form of acceleration provision, the due-on-encumbrance clause, allows lenders to declare the entire debt due if the mortgagor places additional liens upon the real property.[20] The use of the due-on-encumbrance clause, once commonly included in mortgage instruments,[21] declined after the California Supreme Court's decision in *LaSala v. American Savings & Loan Association.*[22] In *LaSala,* the court held that the risk to the senior mortgagee's interest arising from a junior lien did not justify an automatic acceleration of the debt, thereby destroying the usefulness of the due-on-encumbrance clause.[23]

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entailed upon it. But the effect of the stipulation or condition expressed simply is that, if it is alienated or abandoned, or not used for the purposes for which the money was loaned, the mortgage becomes due; if a sale were made, it would simply be made subject to the mortgage.

Id.

16. 150 Ala. 253, 43 So. 782 (1907).

17. *Id.* at 258, 43 So. at 783.

18. *Id.* The court reasoned, "This clause was put in the mortgage for a purpose, and the parties thereto were bound by it. It is not within the power of this court to make contracts for parties." *Id.*

19. Goddard, *Non-Assignment Provisions in Land Contracts,* 31 MICH. L. REV. 1, 7-8 (1932); *see also* Merriam v. Leeper, 192 Iowa 587, 593, 185 N.W. 134, 137 (1921) (court referred to due-on-sale clause as an uncommon provision).

20. For examples of cases discussing due-on-encumbrance clauses, see LaSala v. American Sav. & Loan Ass'n, 5 Cal. 3d 864, 489 P.2d 1113, 97 Cal. Rptr. 849 (1971); and Occidental Sav. & Loan Ass'n v. Venco Partnership, 206 Neb. 469, 293 N.W.2d 843 (1980). The Nebraska Supreme Court pointed out that a due-on-encumbrance clause "is essentially the same as a 'due-on-sale' clause, except that the triggering mechanism is the placing of a subsequent lien or encumbrance upon the mortgaged property." 206 Neb. at 470-71, 293 N.W.2d at 844.

21. *See* Thornburg, *supra* note 7, at 646; *see also* R. KRATOVIL & R. WERNER, MODERN MORTGAGE LAW AND PRACTICE 206-07 (2d ed. 1981). The clause originated to protect against the financial hazard posed to the senior mortgagee. The junior lien usually carries a higher interest rate and has a shorter maturity. This additional financial pressure may force the mortgagor to default on both mortgages. *See id.* at 206-07.

22. 5 Cal. 3d 864, 489 P.2d 1113, 97 Cal. Rptr. 849 (1971).

23. *Id.* at 881, 489 P.2d at 1124, 97 Cal. Rptr. at 860; *see also* Thornburg, *supra* note 8, at 646 (citing *LaSala* as the first decision refusing to enforce due-on-encumbrance clauses).

B. *The Effects of the Depression*

The financial collapse of the Depression triggered the widespread use of due-on-sale clauses in mortgage transactions.[24] During the Depression, lending institutions found their assets tied up in real estate mortgages which could not be converted into cash quickly enough to pay depositors.[25] Lenders that remained open during the Depression reacted to the lack of liquid assets by ceasing to make home mortgage loans.[26] In response to these dire conditions, Congress created the Federal Housing Administration and authorized it to provide mortgage insurance in order to make home financing available.[27] This measure induced some cautious lending—at least more than would have occurred without the safety of the government insurance.[28]

The limited availability of home financing prompted Congress to enact legislation to stimulate mortgage lending.[29] In 1932, Congress enacted the Federal Home Loan Bank Act[30] (Bank Act). The Bank Act established a nationwide system of federal institutions to originate home mortgages directly to borrowers.[31] The Bank Act provided federal assistance and loan advances to encourage the development of new thrift institutions[32] in areas where state-chartered lending institutions were unable to fully serve the demand for mortgage financing.[33] In 1933, Congress enacted the Home Owners' Loan Act[34] (HOLA) to stabilize the home loan market and to protect borrowers from threatening state laws.[35] HOLA also established the Federal Home Loan Bank Board[36] (Bank

24. Kratovil, *A New Dilemma for Thrift Institutions: Judicial Emasculation of the Due-On-Sale Clause,* 12 J. MAR. J. PRAC. & PROC. 299 (1979) [hereinafter cited as Kratovil].

25. *Id.; see also* Comment, *Due-On-Sale Clauses and Restraints on Alienation: Does* Wellenkamp *Apply to Federal Institutions?,* 11 PAC. L.J. 1085, 1103 (1980) (discussion of how California has dealt with due-on-sale clauses). By 1933, 1700 state savings and loan associations had failed, causing $200 million in losses, approximately one-third the value of savings in these institutions. *See* H. R. CONF. REP. NO. 210, 73rd Cong., 1st Sess., 77 CONG. REC. 2499 (1933) (remarks of Rep. Reilly).

26. *See* Kratovil, *supra* note 24, at 299. Kratovil notes that many banks that were closed by President Roosevelt in 1933 never reopened. "Those that did simply made no mortgage loans." *Id.*

27. *See id.*

28. *See id.*

29. T. MARVELL, THE FEDERAL HOME LOAN BANK BOARD 18-25 (1969).

30. Federal Home Loan Bank Act, ch. 522, 47 Stat. 725 (1932) (codified at 12 U.S.C. §§ 1421-1444 (1976)).

31. *Id.* § 1424.

32. *See* T. MARVELL, *supra* note 29, at 20-24.

33. H.R. REP. NO. 1418, 73rd Cong., 1st Sess. 3, 10 (1933); T. MARVELL, *supra* note 29, at 20-27.

34. Home Owners' Loan Act of 1933, ch. 64, 48 Stat. 128 (1933) (codified at 12 U.S.C. §§ 1461-1470 (1982)).

35. *See id.*

36. 12 U.S.C. § 1464 (1982).

The Federal Home Loan Bank Board is an independent federal regulatory agency

Board) which promulgated regulations to "provide for the organization, incorporation, examination, operation, and regulation of associations to be known as 'Federal savings and loan associations.' "[37]

C. *Modern Form of the Clause*

Lending institutions that survived the Depression, as well as the new associations created by HOLA, gradually began mortgage financing.[38] Lenders included due-on-sale clauses in notes[39] and mortgage instruments[40] to avoid the problems experienced at the outset of the Depression.

The early, unsophisticated due-on-sale clause was one of several provisions in a general acceleration clause.[41] The clause granted the lender the right to accelerate the debt if the property was sold without the lender's consent.[42] The clause assured the lender, who had financed a purchase by a creditworthy individual, that the property would only be sold to another creditworthy individual.[43]

Early decisions focused solely on the due-on-sale provision in the general acceleration clause.[44] Because of this judicial attention the due-on-sale clause began to appear as a separate provision, drafted more

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created in 1932 to administer the Home Owners' Loan Act of 1933 (HOLA). The Bank Board is authorized to provide for the organization, examination, and regulation of federal savings and loan associations. 12 U.S.C. § 1464(a) (1976). In 1976 the FHLBB issued due-on-sale regulations which provide that:

> A Federal association continues to have the power to include, as a matter of contract between it and the borrower, a provision in its loan instruments whereby the association may, at its option, declare immediately due and payable all of the sums secured by the association's security instrument if all or any part of the real property securing the loan is sold or transferred by the borrower without the association's prior written consent.

12 C.F.R. § 545.8-3(f) (1983) (repealed 1983).

37. 12 U.S.C. § 1464(a) (1982).

38. Kratovil, *supra* note 24, at 299.

39. *See* BERNHARDT, THE OBLIGATION IN CALIFORNIA REAL ESTATE SECURED TRANSACTIONS § 4.55 at 182-83 (1970). Bernhardt explains the significance of inserting the clause in both the note and the mortgage. One commentator points out that including the clause in the deed of trust imports constructive notice to subsequent purchasers by virtue of recordation, and including a clause in the note binds all parties who sign or guarantee the note. *Id.*

40. Kratovil, *supra* note 24, at 299-300.

41. *See, e.g.,* Baker v. Loves Park Sav. & Loan Ass'n, 61 Ill. 2d 119, 333 N.E.2d 1 (1975). In *Baker* the mortgage included a broad covenant in which the mortgagor agreed:

> (8) not to suffer or permit without written permission or consent of the mortgagee being first had and obtained . . .
> (d) a sale, assignment or transfer of any right, title or interest in and to said property or any portion thereof.

Id. at 121, 333 N.E.2d at 2.

42. R. KRATOVIL & R. WERNER, *supra* note 21, § 14.08 at 204.

43. *Id.*

44. Kratovil, *supra* note 24, at 302.

elaborately.[45]

Although lenders placed greater emphasis on drafting due-on-sale clauses, most clauses written prior to 1975 contained varied language.[46] In addition, many of the provisions did not contain specific language giving the lender an option to increase the interest rate upon an assignment of the mortgage.[47] In 1970, Congress directed the Federal National Mortgage Assocation (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC) to draft a uniform mortgage instrument.[48] The congressional directive was based on the secondary mortgage market's need for a uniform instrument.[49] In June, 1975, the Uniform Mortgage Instrument was released. Paragraph 17 of the Uniform Mortgage Instrument[50] contains the FNMA/FHLMC standard due-on-sale clause which

45. *Id.* at 302-03.

46. *See* Blocher, *Due-On-Sale in the Secondary Mortgage Market,* 31 CATH. U.L. REV. 49, 55 (1981).

47. *See* Comment, Dunham v. Ware Savings Bank: *Economic Policy and Federal Law Justify Enforcement of Due-On-Sale Clauses by State-Chartered Savings Institutions,* 35 ME. L. REV. 147, 148 (1983).

48. S. REP. NO. 761, 91st Cong., 2d Sess. 7, *reprinted in* 1970 U.S. CODE CONG. & AD. NEWS 3488, 3494-95; H.R. REP. NO. 1131, 91st Cong., 2d Sess. 7 (1970).

49. S. DOC. NO. 21, 92d Cong., 1st Sess. iii (1971) (Senator Sparkman stated that "a uniform instrument was essential to the development of a viable secondary mortgage market.").

50. A due-on-sale clause is defined in the Garn Act as a "contract provision which authorizes a lender, at his option, to declare due and payable sums secured by the lender's security instrument if all or any part of the property, or an interest therein, securing the real property loan is sold or transferred without the lender's prior written consent." 12 U.S.C.A. § 1701j-3(a)(1) (West Supp. 1983). The most common due-on-sale clause format used in the market today, known as "Paragraph 17," is that used by the Federal Home Loan Mortgage Corporation (Freddie Mac) and the Federal National Mortgage Association (Fannie Mae) which provides:

> 17. TRANSFER OF THE PROPERTY; ASSUMPTION. If all or any part of the Property or an interest therein is sold or transferred by Borrower without Lender's prior written consent, excluding (a) the creation of a lien or encumbrance subordinate to this Deed of Trust, (b) the creation of a purchase money security interest for household appliances, (c) a transfer by devise, descent or by operation of law upon the death of a joint tenant or (d) the grant of any leasehold interest of three years or less not containing an option to purchase, Lender may, at Lender's option, declare all the sums secured by this Deed of Trust to be immediately due and payable. Lender shall have waived such option to accelerate if, prior to the sale or transfer, Lender and the person to whom the Property is to be sold or transferred reach agreement in writing that the credit of such person is satisfactory to Lender and that the interest payable on the sums secured by this Deed of Trust shall be at such rate as Lender shall request. If Lender has waived the option to accelerate provided in this paragraph 17, and if Borrower's successor in interest has executed written assumption agreement accepted in writing by Lender, Lender shall release Borrower from all obligations under this Mortgage and the Note.
>
> If Lender exercises such option to accelerate, Lender shall mail Borrower notice of acceleration in accordance with paragraph 14 hereof. Such notice shall provide a period of not less than 30 days from the date the notice is mailed within which Borrower may pay the sums declared due. If Borrower fails to pay such

is used in most residential mortgage instruments today.[51]

D. Modern Litigation

Until the mid-1960's there was little litigation concerning due-on-sale clauses.[52] The rise in the number of lawsuits challenging the enforcement of the clause paralleled the inflationary rise of mortgage interest rates.[53] Before this inflationary increase in the rate of interest, mortagees would generally not enforce a due-on-sale clause unless the subsequent buyer was not creditworthy.[54] In 1966, 1970, and 1974, disintermediation[55] occurred when depositors withdrew their funds from savings accounts and placed them in other investments offering higher rates of return.[56] Disintermediation, coupled with the advent of inflationary increases in interest rates, caused lenders to enforce due-on-sale clauses in order to realize market interest on loans that would normally have been locked in at below-market rates for long amortization periods.[57] Enforc-

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sums prior to the expiration of such period, Lender may, without further notice or demand on Borrower, invoke any remedies permitted by paragraph 18 hereof.

Squires, *A Comprehensive Due-on-Sale Clause (with form)*, 27 PRAC. LAW., Apr. 15, 1981, at 67, 71-72.

51. Comment, *supra* note 47, at 150.

52. *Cf.* Bonnano, *Due On Sale and Prepayment Clauses in Real Estate Financing in California in Times of Fluctuating Interest Rates—Legal Issues and Alternatives*, 6 U.S.F.L. REV. 267, 274 (1972) (noting few reported California cases). The absence of litigation may have been due to the relative stability of interest rates at that time. *See* Bartke & Tagaropulos, *Michigan's Looking Glass World of Due-On-Sale Clauses*, 24 WAYNE L. REV. 971, 976-77 (1978) (interest rates were reasonably stable from 1961 to 1965).

53. According to a Department of Commerce abstract, interest rates on conventional existing home mortgages from 1965 to 1979 were as follows:

Year	*Interest Rate*
1965	5.89%
1970	8.56%
1972	7.70%
1973	8.33%
1974	9.23%
1975	9.14%
1976	9.04%
1977	9.00%
1978	9.70%
1979	11.16%

UNITED STATES DEPT. OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 545 (101st ed. 1980).

54. *See* Bartke & Tagaropulos, *supra* note 52, at 979.

55. Disintermediation is simply that point in time when interest rates, particularly those on government securities, rise to a point where money flows out of savings institutions and into government securities, thereby preventing savings institutions from making mortgage loans. Dall, *The Conventional Mortgage-backed Security*, FNMA/FHLMC GENERAL COUNSELS' CONFERENCE 159-60 (1978).

56. R. KRATOVIL & R. WERNER, *supra* note 21, at 204.

57. Williams v. First Fed. Sav. & Loan Ass'n, 651 F.2d 910 (4th Cir. 1981). Interest rate fluctuation is the principal underlying characteristic of home lending activities which

ing due-on-sale clauses guaranteed lenders that their loans would carry present market interest rates, thereby increasing the yield on their mortgage portfolios.[58]

Early decisions generally upheld the lender's right to a enforce a due-on-sale clause unless the result would have been unconscionable.[59] Mortgagors usually argued that the lender's use of the clause amounted to an illegal restraint of their right to freely alienate their property. Mortgagors also claimed that if they were allowed to transfer a mortgage with a below-market interest rate, it would increase the number of potential buyers as well as the price of their property.[60] In contrast, if the lender could demand a higher rate of interest upon the transfer of the property, the economic attractiveness of the transaction for potential purchasers would decrease.[61] In response to these arguments, early opinions concluded that no restraint occurred, and that the financing was totally separate from the property itself.[62] Later decisions, however, did

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leads lenders to insist on due-on-sale clauses. *See id.* at 914. *But see* Volkmer, *The Application of the Restraints on Alienation Doctrine to Real Property Security Interests,* 58 IOWA L. REV. 747, 770 (1973) (interest rate considerations were an original purpose behind the development of due-on-sale clauses).

58. *See Holiday Acres*, 308 N.W.2d at 481.

59. *See* First Fed. Sav. & Loan Ass'n of Englewood v. Lockwood, 385 So. 2d 156 (Fla. Dist. Ct. App. 1980). A due-on-sale clause was enforceable as a reasonable restraint on alienation only if enforcement was not inequitable or unjust under the circumstances. *Id.* at 160; *see also Baker*, 61 Ill. 2d at 126, 333 N.E.2d at 5 (court of equity may relieve borrower from effect of due-on-sale clause when exercise of clause is result of unconscionable or inequitable conduct by lender; an attempt to impose excessive interest rate in relation to market rate would be unconscionable); *Occidental*, 206 Neb. at 482, 293 N.W.2d at 850 (enforcement of due-on-sale clause is valid absent evidence that enforcement would be inequitable); Mills v. Nashua Fed. Sav. & Loan Ass'n, 121 N.H. 722, 725, 433 A.2d 1312, 1314 (1981) (due-on-sale clauses contained in mortgage instruments are not per se invalid); Mutual Real Est. Inv. Trust v. Buffalo Sav. Bank, 90 Misc. 2d 675, 678, 395 N.Y.S.2d 583, 586 (N.Y. Sup. Ct. 1977) (court of equity may refuse to enforce due-on-sale clauses under certain circumstances); Stith v. Hudson City Sav. Inst., 63 Misc. 2d 863, 866, 313 N.Y.S.2d 804, 808 (N.Y. Sup. Ct. 1970) (due-on-sale clause was not a forfeiture or penalty and therefore was fair and legal); Crockett v. First Fed. Sav. & Loan Ass'n, 289 N.C. 620, 630-31, 224 S.E.2d 580, 587 (1976) (due-on-sale clause was valid and enforceable absent proof that lender acted fraudulently, inequitably, oppressively, or unconscionably); Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 615 S.W.2d 333, 340 (Tex. Civ. App. 1981) (Texas courts have not permitted enforcement of acceleration clauses activated by a lender's fraudulent and inequitable conduct).

60. Bartke & Tagaropulos, *supra* note 52, at 981-82.

61. Bonnano, *supra* note 52, at 284-85.

62. *See* Malouff v. Midland Fed. Sav. & Loan Ass'n, 181 Colo. 294, 301, 509 P.2d 1240, 1244 (1973); *Baker*, 61 Ill. at 125, 333 N.E. 2d at 4; Chapman v. Ford, 246 Md. 42, 50, 227 A.2d 26, 31 (1967); First Commercial Title, Inc. v. Holmes, 92 Nev. 363, 365, 550 P.2d 1271, 1272 (1976); Poydan, Inc. v. Agia Kiriaki, Inc., 130 N.J. Super. 141, 150, 325 A.2d 838, 843 (1974); *Mutual Real Estate*, 90 Misc. 2d at 678, 395 N.Y.S.2d at 586; *Crockett*, 289 N.C. at 630-31, 224 S.E.2d at 587; Peoples Sav. Ass'n v. Standard Indus., Inc., 22 Ohio App. 2d 35, 38, 257 N.E.2d 406, 408 (1970); Walker Bank & Trust Co. v. Neilson, 26 Utah 2d 383, 386, 490 P.2d 328, 329 (1971).

not allow enforcement of the clause unless the mortgagee demonstrated that the proposed transfer threatened to impair its security interest in the mortgaged property.[63]

In hopes of clarifying the controversy between mortgagees and mortgagors regarding due-on-sale clauses, the Bank Board promulgated regulations (1976 Regulations)[64] which generally allowed the enforcement of due-on-sale clauses by federally-chartered savings and loans.[65] The 1976 Regulations, however, came under judicial scrutiny on the issue of whether the regulations had the effect of preempting state restrictions on the enforcement of due-on-sale clauses. In *Holiday Acres No. 3 v. Midwest Federal Savings & Loan Association,*[66] the Minnesota Supreme Court held

63. *See* Patton v. First Fed. Sav. & Loan Ass'n, 118 Ariz. 473, 479, 578 P.2d 152, 158 (1978) (due-on-sale clause enforceable only upon beneficiary's showing that security was jeopardized by a transfer of the property; without such a showing, enforcement would be an unlawful restraint on alienation); Wellenkamp v. Bank of Am., 21 Cal. 3d 943, 952, 582 P.2d 970, 973, 148 Cal. Rptr. 379, 384 (1978) (impairment of security must be established in order to exercise clause); Woodcrest Apartments, Ltd. v. IPA Realty Partners, 397 So. 2d 364, 366 (Fla. Dist. Ct. App. 1970); Nichols v. Ann Arbor Fed. Sav. & Loan Ass'n, 73 Mich. App. 163, 174, 250 N.W.2d 804, 809 (1977) (where sole basis for enforcement of due-on-sale clause was lender's interest in maintaining its loan portfolio at current interest rates, restraint on the mortgagor's ability to alienate was unreasonable); State *ex rel.* Bingaman v. Valley Sav. & Loan Ass'n, 97 N.M. 8, 12, 636 P.2d 279, 283 (1981) (court held there was no enforcement without showing of substantial impairment to lender's security interest); Bellingham First Fed. Sav. & Loan Ass'n v. Garrison, 87 Wash. 2d 437, 441-42, 553 P.2d 1090, 1092 (1976) (increased risk to lender allowed enforcement of due-on-sale clause); *cf.* Continental Fed. Sav. & Loan Ass'n v. Fetter, 564 P.2d 1013, 1019 (Okla. 1977) (equitable powers of court will not impose penalty on mortgagor without a showing he has violated the substance of the agreement).

64. 12 C.F.R. § 545.8-3(f) (1982) (repealed 1983). This section provided:

> *Due-on-sale clauses.* [A federal savings and loan] association continues to have the power to include, as a matter of contract between it and the borrower, a provision in its loan instrument whereby the association may, at its option, declare immediately due and payable sums secured by the association's security instrument if all or any part of the real property securing the loan is sold or transferred by the borrower without the associations' [sic] prior written consent. Except as [otherwise] provided in . . . this section . . . exercise by the association of such option (hereinafter called a due-on-sale clause) shall be exclusively governed by the terms of the loan contract, and all rights and remedies of the association and borrower shall be fixed and governed by the contract.

Id.

65. *Id.* § 545.8-3(g) (1982) (repealed 1983). This section provided:

> *Limitations on the exercise of due-on-sale clauses.* With respect to any loan made after July 31, 1976, on the security of a home occupied or to be occupied by the borrower, a Federal association (1) shall not exercise a due-on-sale clause because of (i) creation of a lien or other encumbrance subordinate to the association's security instrument; (ii) creation of a purchase money security interest for household appliances; (iii) transfer by devise, descent, or operation of law on the death of a joint tenant; or (iv) granting of a leasehold interest of three years or less not containing an option to purchase.

Id.

66. 308 N.W.2d 471 (Minn. 1981).

that there was no federal preemption.[67]

1. Holiday Acres

In *Holiday Acres,* the Minnesota Supreme Court addressed the impact of the 1976 Regulations on due-on-sale clause acceleration by holding that the 1976 Regulations did not preempt state law because neither Congress nor the Bank Act *expressly* provided for preemption of state law regarding the enforcement of due-on-sale clauses.[68] The court reasoned that "[h]ome loan mortgages, and the inclusion of due-on-sale clauses in those mortgages, are matters of traditional state interest and concern."[69] The court stated that federal law would not supersede the historic police powers of the state "unless that was the clear and manifest purpose of Congress."[70] The court also inquired into the possibility of implied preemption by Congress and held that the 1976 Regulations were not evidence of any congressional intent to fully occupy the field.[71] Indeed, the congressional intent on the issue of preemption was entirely unclear.[72]

The court's findings are supported by the legislative history underlying the 1976 Regulations. In 1933 the Chairman of the Bank Board stated at a House hearing that the Bank Board would not preempt state law.[73] On the other hand, the legislative history of the HOLA demonstrated that Congress intended the Bank Board to have broad powers to administer the Bank Act.[74] Nevertheless, the Minnesota court was correct in finding that the legislative intent was ambiguous since there is no *clear* congressional intent to preempt state law.

The Minnesota Supreme Court recognized that lenders, particularly in residential financing, use due-on-sale clauses as leverage "to negotiate a higher rate of interest or, in the alternative . . . to declare the entire

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67. *Id.* at 477.

68. *Id.*

69. *Id.* at 475.

70. *Id.* at 476 (citing Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947)).

71. 308 N.W.2d at 478.

72. Note, *Enforceability of Federal Savings and Loan Association Due-On-Sale Clauses: Holiday Acres No. 3 v. Midwest Federal Savings & Loan Association,* 66 MINN. L. REV. 1141, 1146 (1982).

73. H.R. REP. NO. 4980, 73d Cong., 1st Sess. 23-24 (1933) (statement of William F. Stevenson, Chairman, Federal Home Loan Bank Board). According to Chairman Stevenson,

> These associations will be federally chartered and the regulations as to how these things will be done are drawn by the board and put into effect. But they would be very careful, I should say. I know I would as a member of the board, be very careful in authorizing them to do things that they were not authorized to do under state law. I do not think that would be our policy.

Id.; see also Holiday Acres, 308 N.W.2d at 476-77.

74. *See* 77 CONG. REC. at 2481 (statement of Rep. Luce) ("We give the board great power to administer the Act."); *see also* Glendale Fed. Sav. & Loan Ass'n v. Fox, 459 F. Supp. 903 (C.D. Cal. 1978) (plenary authority granted by Congress to the Board evidences exclusive control sufficient for federal preemption).

balance due and owing, thereby obtaining the funds to lend at higher existing interest rates."[75] By forcing refinancing at current interest rates, the mortgagee collects more money for profit or lending to other borrowers.[76] The disadvantaged borrower-seller is, therefore, forced to lower the selling price of his home to compensate for the higher financing costs to a potential buyer or to forego selling his property.[77]

Even though *Holiday Acres* involved a loan to finance investment residential property, the Minnesota Supreme Court elaborated in dicta on the unjust restraint on alienation of borrower-occupied residential property when due-on-sale clauses are used for purposes other than to protect the lender's security interest.[78] The court held that the economic concerns and the need for quick and easy transfers of investment residential property, where agreements are usually negotiated by experienced business people, is not nearly as compelling as that of borrower-occupied residential property.[79] The court therefore permitted the enforcement of the due-on-sale clause in *Holiday Acres,* allowing the mortgagee to require refinancing of the investment loan.[80] Even though borrower-occupied residential property was not at issue in the case, the Minnesota Supreme Court strongly stated in dicta that enforcement of due-on-sale clauses in the transfer of borrower-occupied residential property is "*per se* unreasonable except to protect against impairment of the lender's security interest."[81]

2. de la Cuesta

Soon after *Holiday Acres,* the California Court of Appeals concurred with the Minnesota court's *Holiday Acres* holding regarding preemption in *Fidelity Federal Savings & Loan Association v. de la Cuesta.*[82] The California court held that the 1976 Regulations permitting the enforcement of due-on-sale clauses did not preempt a California statute limiting the enforcement of due-on-sale clauses.[83]

On appeal, the United States Supreme Court framed the issue as whether the Bank Board intended to preempt California's law on due-on-sale clauses, and if so, whether that action was within the scope of the Bank Board's delegated authority.[84] The Court held that the Bank

75. *Holiday Acres,* 308 N.W.2d at 481.
76. *Id.*
77. *Id.* at 481.
78. *Id.* at 484.
79. *Id.*
80. *Id.*
81. *Id.*
82. 121 Cal. App. 3d 328, 175 Cal. Rptr. 467 (Cal. Ct. App. 1981), *rev'd,* 458 U.S. 141 (1982).
83. 121 Cal. App. 3d at 341, 175 Cal. Rptr. at 474.
84. Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 154 (1982). According to the Supreme Court, when Congress directs an administrator to exercise discre-

Board had the power to preempt state law because "federal regulations have no less preemptive effect than federal statutes."[85] Justice Blackmun set forth a new test to be applied to the issue of preemption of state law by federal regulation.[86] This test examines the administrative agency's intent and whether the agency exceeded its congressional grant of authority or acted arbitrarily.[87]

Applying this test, the Court held that the Bank Board's intent to preempt state law was unambiguous.[88] Upon examination of the legislative history underlying the Bank Board's creation, the Court held that there was congressional intent to grant the Bank Board preemptive power based on the statutory definition of the Bank Board's powers.[89] In light of the legislative language, the Court stated, it would be difficult to imagine a statute granting greater administrative control.[90]

In *de la Cuesta* the Supreme Court voiced its concern for federal lenders and their financial problems resulting from holding long-term mortgages at low interest rates during a time of high inflation and high market interest rates.[91] The Court held that savings and loans will be able to exercise due-on-sale clauses forcing refinancing at current interest rates.[92] Lending associations will thereby be able to alleviate their financial problems and to continue to fund loans for new residential home buyers.[93]

The opinion in *de la Cuesta,* therefore, prohibits state restrictions on the enforcement of due-on-sale clauses for loans originating from federally-

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tion in carrying out his duties, the scope of judicial review is limited to a determination of whether he exceeded his statutory authority or acted arbitrarily. United States v. Shimer, 367 U.S. 374, 381-82 (1961).

85. 458 U.S. at 153.

86. *Id.* at 153-54.

87. *Id.* at 153; *see* Blum v. Bacon, 457 U.S. 132, 141 (1982) (interpretation by an agency charged with administration of a statute is entitled to substantial deference); Ridgway v. Ridgway, 454 U.S. 46, 57 (1981) (regulations must not be "unreasonable, unauthorized, or inconsistent with the underlying statute"); *see also Shimer,* 367 U.S. 374, 383 (the administrator's choice should not be disturbed unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned).

88. 458 U.S. at 157-59. The Court based its position on Title 12 of the Code of Federal Regulations, § 545.8-3(f) (1982) which states that a federal savings and loan association continues to have the power "to include, and enforce, at its option, a due-on-sale clause." *See supra* note 67 and accompanying text.

89. 458 U.S. at 160. The language cited by the Court states:

> [T]he Board is authorized, under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation and regulation of associations to be known as 'Federal Savings and Loan Associations.'

12 U.S.C. § 1464(a)(1) (1976).

90. 458 U.S. at 161; *see also Glendale,* 459 F. Supp. at 910 ("It would have been difficult for Congress to give the Bank Board a broader mandate").

91. *See* 458 U.S. at 168-69.

92. *Id.* at 169-70.

93. *Id.* at 168-69.

chartered savings and loan associations.[94] The decision criticized the Minnesota court's holding in *Holiday Acres* with respect to the federal preemption issue.[95] Since *de la Cuesta* applies only to mortgages originating from federally-chartered savings and loans, the decision produced more confusion in the mortgage market regarding mortgages originating from state savings and loan associations.[96]

III. THE GARN ACT

A. Legislative History

In the wake of *de la Cuesta,* both the Senate and House Banking, Housing and Urban Affairs Committees began to consider legislation to address the problems and questions arising from the enforcement of due-on-sale clauses[97] and the incidence of state restrictions on a nationwide scale.[98] The Senate Committee found "compelling" reasons for enacting legislation to deal with state restrictions.[99] The Committee noted that the state restrictions placed existing home buyers in an advantageous position at the expense of new home purchasers because new home buyers paid for the due-on-sale restrictions in one of two ways.[100] The new

94. In a dissenting opinion, however, Justice Rehnquist stated that it was unconstitutional to allow the enforcement of due-on-sale clauses merely for economic reasons. *Id.* at 175 (Rehnquist, J., dissenting). Justice Rehnquist reasoned that the promulgation of the 1976 Regulations exceeded the Bank Board's authority granted by Congress and that the Bank Board departed from the administrative approach contemplated by Congress. *Id.* at 173-74. The dissent relied on section 8 of the Federal Home Loan Bank Act of 1932, 12 U.S.C. § 1428 (1976). 458 U.S. at 173.

The administrative approach envisioned by Congress did not include direct preemption. Rather, the HOLA was designed to allow the Bank Board to limit the operation of the federal savings and loan system in states with unsatisfactory laws until economically sound laws were enacted by the state legislatures. *Id.* at 175. The dissent stated that contract and property law are the traditional domain of state law and "[d]ischarge of its (the HOLA's) mission to ensure the soundness of federal savings and loans does not authorize the Federal Home Loan Bank Board to intrude into the domain of state property and contract law that Congress has left to the States." *Id.* at 177.

95. Justice Blackmun made several specific references to *Holiday Acres. See, e.g.,* 458 U.S. at 151 n.9, 170 n.23.

96. *See* 128 CONG. REC. H2451-74 (daily ed. May 20, 1982) (statement of Rep. Wylie) ("Most people, I might say, do not distinguish between a savings and loan and a bank.").

97. *See supra* note 50 and accompanying text (text of FMMA/FHLMC standard due-on-sale clause).

98. S. REP. NO. 536, 97th Cong., 2d Sess., *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 3054, 3067-79 [hereinafter cited as SENATE REPORT].

99. *Id.* at 3074; *see also* 128 CONG. REC. H2451-74 (daily ed. May 20, 1982) (statement of Rep. St. Germain) (Garn Act intended to "revitalize the housing industry by strengthening the financial stability of home mortgage lending and insuring the availability of home mortgage loans").

100. SENATE REPORT, *supra* note 98, at 3074-75. The committee noted that new home buyers are placed at a disadvantage. While it is true this result might occur, it is unclear why the committee made a distinction between buyers of existing homes and buyers of new homes, as these disadvantages would apply to all home buyers. Presumably, the com-

home purchaser either paid the existing homeowner an inflated price for the property because of the attractive financing available at a below-market interest rate on an assumable mortgage[101] or paid a premium for a new loan written at market rates for a new home or an existing home without an assumable mortgage.[102]

The Senate Committee found that in the first instance the disadvantage to the buyer resulted from the seller's desire to either recover losses arising if he took back a second mortgage at below-market interest rates or to reflect the great value of assuming a low interest loan.[103] In the second situation, the Committee reasoned that the lender was forced to charge a premium for the new loan to offset the loss of earnings and the greater risk caused by older mortgages that could not be refinanced because the due-on-sale clauses were unenforceable.[104] The Senate Committee determined that state restrictions on due-on-sale clauses encouraged "risky lending practices."[105] These risky practices, such as contracts for deed, do not include the historical equity of redemption grace period; they thus increase the possibility of default.[106]

The Senate Committee noted that due-on-sale clauses needed to be enforced to increase the lender's yield on mortgage portfolios.[107] The due-on-sale restrictions which allowed the assumption of existing mortgages continued the lives of older, low-interest mortgages. State restrictions would, therefore, eventually threaten the future availability of long-

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mittee meant first-time home buyers or buyers new to the market who did not own a home at the time of entry. *See* TASK FORCE ON DUE-ON-SALE, FEDERAL HOME LOAN BANK BD., FINAL REPORT AND TECHNICAL PAPERS ON THE TASK FORCE ON DUE-ON-SALE at 9 (March, 1982) [hereinafter cited as TASK FORCE].

101. *See* SENATE REPORT, *supra* note 98, at 3074; TASK FORCE, *supra* note 100, at 19. The author of the task force report set forth the proposition that the lender loses income by not being able to reloan the principal at market rates. *See id.* at 3. This lost income is recouped by the home buyer who assumes the loan at below market interest rates. *See id.* at 3-4. The buyer then compensates the seller for this income with a higher selling price. *See id.* at 4.

102. *See* SENATE REPORT, *supra* note 98, at 3074.

103. *See id.* This conclusion is based on the fact that an older mortgage is "difficult to assume because assumption requires a much larger initial payment by the prospective buyer, or a large second mortgage or take back by the seller." *Id.*

104. *See id.* at 3074-75.

105. *Id.* at 3075. "Due-on-sale restrictions also encourage risky lending practices, outside the realm of the traditional mortgage credit delivery system, which intensify default risks." *Id.*

106. *See id.; see also* TASK FORCE, *supra* note 100, at 11-12. Creative financing, such as a contract for deed, usually involves junior mortgage loans and balloon payments. *Id.* at 11. These short-term loans and balloon payments often resulted in default during the Depression because inflation deteriorated the ability of the borrower to meet his payments. Today, the borrower on such financing instruments gambles that interest rates will drop so that he will be able to refinance with a traditional lending instrument. *Id.* at 12.

107. SENATE REPORT, *supra* note 98, at 3075.

term, fixed-rate mortgages.[108] This type of mortgage, the Senate Committee noted, was the "traditional mainstay of American homeowners."[109]

The Senate Committee based its conclusion regarding the state restrictions' effects on fixed-term mortgages in a study conducted by the Due-On-Sale Task Force (Task Force) which was assembled by the Bank Board.[110] In its study, the Task Force predicted that by 1984, state restrictions on enforcement of due-on-sale provisions would create annual losses of six to eight hundred million dollars for federal savings and loans,[111] and annual losses exceeding one billion dollars for all federal and state savings and loan associations.[112] In addition, the Task Force estimated an increase of fifteen to seventeen percent in the number of associations that would need federal assistance by the end of 1983 if the enforcement restrictions extended nationwide.[113]

The Senate Committee also noted the detrimental effect of the unenforceability of due-on-sale clauses on the secondary mortgage market.[114] The secondary mortgage market has traditionally relied on a standard, uniform mortgage instrument.[115] Uniformity provided the secondary mortgage market investor with the assurance of consistency in mortgages originating from diverse sources.[116] Investors could assess the risks and rates of return in a prudent manner with a standard mortgage docu-

108. *Id.*

109. *Id.*

110. *See* TASK FORCE, *supra* note 100.

111. *Id.* at 2, 18; *see* SENATE REPORT, *supra* note 98, at 3075; *see also* 128 CONG. REC. S12213-16 (daily ed. Sept. 24, 1982) (statement of Sen. Riegle) ("More than 1,000 savings and loan associations—one-fourth of all the savings and loan associations in the country—have insufficient net worth to survive the next 2 years at their current loss rate").

112. 128 CONG. REC. S12213 (daily ed. Sept. 24, 1982) (statement of Sen. Riegle). These projected losses were based on two possible interest rate conditions over the two-year period from 1982 to 1984. TASK FORCE, *supra* note 100, at 18-22. Both conditions assumed mortgage interest rates would drop slightly over that two-year period with the lower loss figure based on an interest rate decrease to fourteen percent, the higher loss figure based on an interest rate decrease to sixteen percent. *Id.*

113. TASK FORCE, *supra* note 100, at 26.

114. SENATE REPORT, *supra* note 98, at 3075; *see also* Note, *The Due-On-Clause: A Preemption Controversy,* 10 LOY. L.A.L. REV. 629, 638-39 (1977) (unless due-on-sale clauses are enforced, loans will become less marketable in the secondary market).

115. Shontell, Schoepke & Cassidy, *Effects of State Due-on-Sale Restrictions on the Secondary Mortgage Market,* TASK FORCE, *supra* note 100, at 4.1-4.2.

116. *Id.* These authors noted that:

> When each mortgage of a pool of mortgages has the same features, the pool is homogeneous; that is, investors can assess the pool as a single entity, without concern for its component parts. This uniformity is the foundation of the conventional secondary mortgage market because it provides an independent third party, the investor, with the assurance of consistency in the mortgages originated from diverse sources. Given a set of standard information, investors are able to assess their risks and rates of return, and distribute their funds among investment alternatives accordingly.

Id.

ment.[117] The state due-on-sale restrictions, however, removed the assumption of uniformity, shifting a greater portion of the interest rate risk onto the investor.[118] In response to state restrictions, investors in the secondary mortgage market hesitated to invest in mortgages which originated in states restricting the enforcement of due-on-sale clauses.[119]

The Senate Committee found that because the narrow holding in *de la Cuesta*[120] applied only to federal associations, state-chartered savings and loans and other lenders were placed at a significant disadvantage.[121] *De la Cuesta* also left the average consumer more confused and uncertain as to the enforceability of due-on-sale provisions.[122] Therefore, the Senate Committee determined that "[t]he pre-emption of state due-on-sale restrictions will place all lenders on a more competitive footing, and eliminate the confusion surrounding enforceability of due-on-sale."[123]

Although Congress intended to rectify the confusion caused by *de la Cuesta,* the Garn Act[124] created additional confusion for the consumer, investors in the secondary mortgage market, and lending institutions. The Garn Act's remedy for the problems facing the lending industry did not attempt to balance these existing hardships between lenders and borrowers. Rather, the Act preempts most state restrictions and allows lenders to enforce the due-on-sale clause subject to some minor, limited exceptions.

B. The Act

The Garn Act sets forth a blanket authorization for the enforcement of due-on-sale clauses by all mortgage lenders. The Garn Act thus preempts state constitutions, statutes, and judicial decisions which restrict the enforcement of due-on-sale clauses with certain exceptions.[125]

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117. *Id.*

118. *Id.* Non-uniformity will result in greater risks and "discounts on mortgage-backed securities and a reallocation of funds away from the housing industry to more stable, uniform sources of investment." *Id.*

119. *See* SENATE REPORT, *supra* note 98, at 3075. The Committee noted that state restrictions have caused the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Corporation to change their investment practices in several states. *Id.*

120. *See id.*

121. *Id.;* Comment, *Due-On-Sale Clauses After Passage of the Garn Act: More Questions Than Answers?,* 20 SAN DIEGO L. REV. 897, 898 (1983) According to this Comment, lenders unaffected by *de la Cuesta* were at a disadvantage because they could not enforce the clause and update their portfolios. Lenders affected by *de la Cuesta* had only an "illusory advantage" because buyers preferred not to deal with lenders who could enforce the clause. *Id.*

122. SENATE REPORT, *supra* note 98, at 3075.

123. *Id.*

124. 12 U.S.C.A. § 1701j-3 (West Supp. 1983).

125. 12 U.S.C.A. § 1701j-3 (West Supp. 1983). This section provides:

> In the case of a contract involving a real property loan which was made or assumed . . . during the period beginning on the date a state adopted a constitutional provision or Statute prohibiting the exercise of due-on-sale clauses, or the date on which the highest court of such State has rendered a decision . . .

Section 1701j-3 of the Garn Act addresses the preemption issue raised in *de la Cuesta* and *Holiday Acres* with a direct statement of congressional intent to preempt state law.[126] The congressional power underlying the Act was based on the commerce clause[127] and the rationale that real estate financing and due-on-sale clauses affect interstate commerce.[128]

The broad scope of the Garn Act's preemption provision is subject to very few limitations.[129] It applies to all lenders, including state- and federally-chartered institutions, private institutions, individuals,[130] and governmental agencies such as the FHA and VA.[131]

The Garn Act does not expressly state whether it covers contracts for deed.[132] Nevertheless, the broad definition of "lender,"[133] coupled with an equally broad definition of "real property loan,"[134] could bring contracts for deed under the auspices of the Act.[135] The definition of real property loan includes a "credit sale secured by a lien on real property."[136] The Garn Act's apparent treatment of contracts for deed as mortgages does not signal a notable change in Minnesota law since prior Minnesota case law suggests that contracts for deed constitute liens or

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prohibiting such exercise, and ending on the date of the enactment of this section [Oct. 15, 1982], the provisions of subsection (b) shall apply only in the case of a transfer which occurs on or after the expiration of 3 years after the date of enactment of this Act . . . .

Id.

The seminal provision appears in § 1701j-3(b)(1). This section provides: "Notwithstanding any provision of the constitution or laws (including the judicial decisions) of any State to the contrary, a lender may . . . enter into or enforce a contract containing a due-on-sale clause with respect to a real property loan." *Id.*

126. *See* Barad & Layden, *Due on Sale Law as Preempted by the Garn-St. Germain Act,* 12 REAL EST. L.J. 138, 140 (1983); Wertheim, *Due-On-Sale III: The New Federal Preemption,* 1 MINN. REAL EST. L.J. 113 (1982).

127. U.S. CONST. art. I, § 8, cl. 3.

128. *See* Wertheim, *supra* note 126, at 113 (due-on-sale clauses particularly affect commerce in the sale of mortgages in the secondary mortgage market); *see also* Sanders, *Congress legislates on "due-on-sale" mortgage clauses,* FLA. B.J., Jan. 1983, at 53, 54. Sanders noted that in addition to the secondary mortgage market consideration, the increased mobility of the American home buying population brings mortgages under the commerce clause. *Id.* at 54-55.

129. *See* Rom, *The Garn Bill and Due-On-Sale Clauses in Minnesota,* HENNEPIN LAW., Jan.-Feb. 1983, at 8.

130. 12 U.S.C.A. § 1701j-3(a)(2) (West Supp. 1983); *see* Rom, *supra* note 129, at 8.

131. *See* 12 U.S.C.A. § 1701j-3(a)(2). Under this section a lender is defined as "a person or government agency making a real property loan or any assignee or transferee, in whole or in part, of such person or agency." *Id.* This broad definition is intended to encompass private individuals, private institutions, government lenders such as the FHA and VA, and the secondary mortgage market.

132. Rom, *supra* note 129, at 8.

133. *See* 12 U.S.C.A. § 1701j-3(a)(2) (West Supp. 1983).

134. *See id.* § 1701j-3(a)(3).

135. *See* Wertheim, *supra* note 126, at 113.

136. § 1701j-3(a)(3); *see* Wertheim, *Due-On-Sale Clauses in Minnesota,* 1 MINN. REAL EST. L.J. 33, 39 (1982).

encumbrances.[137]

The Garn Act's definition of a due-on-sale clause is also very inclusive, providing:

> [T]he term 'due-on-sale clause' means a contract provision which authorizes a lender, at its option, to declare due and payable sums secured by the lender's security instrument if all or any part of the property, or any interest therein, securing the real property loan is sold or transferred without the lender's prior written consent.[138]

This statutory language does not, however, require any notice of interest rate adjustments[139] as the FNMA/FHLMC's uniform mortgage instrument demands.[140] Congress limited this definition by stating that the lender's right to exercise the due-on-sale clause is governed exclusively by the instrument.[141] Thus, if the mortgage clause merely requires the lender's consent, without referring specifically to a right of acceleration, the due-on-sale definition probably will not imply such a provision.[142]

The Garn Act sets forth nine conditions under which a due-on-sale clause cannot be enforced.[143] These provisions apply to all loans, includ-

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137. Nichols v. L & O, Inc., 293 Minn. 17, 196 N.W.2d 465 (1972) (relationship of vendor and vendee is analogous to that of mortgagor and mortgagee); State *ex rel.* Blee v. City of Rochester, 260 Minn. 151, 109 N.W.2d 44 (1961) (vendor in contract for deed occupies a position substantially analogous to that of mortgagee); *In re* S.R.A., Inc., 219 Minn. 493, 18 N.W.2d 442 (1945), *aff'd,* 327 U.S. 558 (1946) (difference between security right obtained under mortgage and that provided by executory sales contract is a matter of form only); First & Am. Nat'l Bank of Duluth v. Whiteside, 207 Minn. 537, 292 N.W. 770 (1940) (relationship between vendor and vendee was similar to that created by a mortgage); Summers v. Midland Co., 167 Minn. 453, 209 N.W. 323 (1926) (contract vendor holds legal title merely as security for payment of purchase price, therefore his interest is a lien). *But see* Nelson & Whitman, *The Installment Land Contract: A National Viewpoint,* 1977 B.Y.U.L. REV. 541. These commentators suggest that it is socially advantageous for the law to provide a quick and inexpensive way for the vendor to terminate because it encourages the extension of credit to people whose credit is so poor they would not otherwise be able to purchase a home. *Id.* at 561. The authors also indicate that judicial conversion of a contract for deed into a mortgage in order to provide an equity of redemption may force the vendor to litigate. This is the result the vendor hoped to avoid by using a contract for deed. *Id.; see also* Hetland, *The California Land Contract,* 48 CALIF. L. REV. 729, 773-74 (1960) (increase of vendee's rights, including judicial conversion of a contract for deed into a mortgage, made contract for deed legally obsolete in California).

138. § 1701j-3(a)(1).

139. Sanders, *supra* note 128, at 53.

140. *See supra* note 99 and accompanying text.

141. *See* § 1701j-3(b)(2); *see also* McGuire, *The Due-On-Sale Controversy: Restraints on Alienation and Federal Regulation of Real Estate Mortgages After* de la Cuesta *and the Garn-St. Germain Act,* 1982 S. ILL. U.L.J. 487. McGuire notes that because all rights and remedies of the lender and borrower are fixed and governed by the contract, this language suggests that a borrower may not invoke the equitable defenses of laches, waiver, estoppel, and unconscionability. *Id.* at 525.

142. Sanders, *supra* note 128, at 53; *see Young,* 624 P.2d at 237 (court concluded it would be improper to imply a due-on-sale clause where none existed).

143. § 1701j-3(d). This section provides:

> [A] lender may not exercise its option pursuant to a due-on-sale clause upon—

ing window period loans,[144] and all lenders, including federal savings and loan institutions.[145] The nine conditions include the four exceptions listed in the federal regulations promulgated by the Bank Board in 1976[146] and found in Paragraph 17 of the uniform FNMA/FHLMC standard mortgage instrument.[147] The other exceptions relate to family transfers or transfers used in estate planning.[148] These exceptions are not intended to "facilitate financing arrangements which are designed to circumvent the legitimate right of a lender to enforce a due-on-sale clause, rather, [they are intended] to provide protections for consumers by prohibiting the enforcement of due-on-sale clauses where such enforcement would be inequitable."[149]

C. *Window Period Exception*

In addition to the nine exceptions, the window period provides the most noteworthy exception to the enforcement of due-on-sale clauses.[150] The Act defines a window period loan as one:

> which was made or assumed, including a transfer of the liened property subject to the real property loan, during the period beginning on the date a State adopted a constitutional provision or statute prohibiting the exercise of due-on-sale clauses, or the date on which the highest court of such State has rendered a decision . . . prohibiting such exercise, and ending on October 15, 1982 [date of enactment of this

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(1) the creation of a lien or other encumbrance subordinate to the lender's security instrument which does not relate to a transfer of rights of occupancy in the property;
(2) the creation of a purchase money security interest for household appliances;
(3) a transfer by devise, descent, or operation of law on the death of a joint tenant or tenant by the entirety;
(4) the granting of a leasehold interest of three years or less not containing an option to purchase;
(5) a transfer to a relative resulting from the death of a borrower;
(6) a transfer where the spouse or children of the borrower become an owner of the property;
(7) a transfer resulting from a decree of a dissolution of marriage, legal separation agreement, or from an incidental property settlement agreement, by which the spouse of the borrower becomes an owner of the property;
(8) a transfer into an inter vivos trust in which the borrower is and remains a beneficiary and which does not relate to a transfer of rights of occupancy in the property; or
(9) any other transfer or disposition described in regulations prescribed by the Federal Home Loan Bank Board.

Id.

144. Wertheim, *supra* note 126, at 116.

145. SENATE REPORT, *supra* note 98, at 3067-79 (neither state nor federal regulatory agencies may override these exceptions).

146. *See* 12 C.F.R. § 545.34 (1984) (due-on-sale clauses subject to the provisions of the Garn Act).

147. *See supra* note 50 (text of Paragraph 17) and accompanying text.

148. Wertheim, *supra* note 126, at 116.

149. SENATE REPORT, *supra* note 98, at 3079.

150. § 1701j-3(c)(1)(A) and (B).

section].[151]

A window period mortgage is one that was originated or assumed during the period when state law restricted due-on-sale enforcement. The window period can be triggered by a state statute, constitutional provision, or judicial decision.[152] A state which did not restrict enforcement of due-on-sale clauses prior to the enactment of the Garn Act does not have a window period.[153] The legislative history underlying the window period exception indicates that the period is primarily transitional and designed to avoid inequity for those home buyers "who, despite the contractual terms of their mortgage contracts, relied on state due-on-sale restrictions and reasonably believed they had assumable loans."[154]

The mere existence of a window period loan depends on the lender originating the loan.[155] The Garn Act incorporates the *de la Cuesta* decision[156] by stating that due-on-sale enforcement for federally-chartered savings and loans is subject to the Bank Board's exclusive authority.[157] Therefore, the window period exception does not apply to loans originated by federally-chartered savings and loans.[158] Only loans originated by non-federally-chartered lenders are eligible for treatment as window period loans. To cover situations in which a state-chartered lender converts to a federally-chartered institution, Congress provided that the identity of the mortgagee at the time the loan originated determines whether a loan falls within the window period exception.[159]

Loans eligible for treatment as window period loans will be subject to applicable state restrictions only from October 15, 1982 to October 15, 1985,[160] unless a state legislature acts within this three-year period to pass legislation regarding window period loans.[161] The three-year transition period allows state legislatures to review the impact of the due-on-sale restrictions, to weigh the rights of consumers who have window period mortgages or who are trying to assume such a loan, and to adopt a different approach to window period loans if they choose.[162] For example, a state legislature may repeal the restrictions on the enforcement of window period due-on-sale clauses, lengthen the time due-on-sale restrictions apply—presumably for the life of the loan, or authorize or mandate

151. *Id.*
152. SENATE REPORT, *supra* note 98, at 3076.
153. *Id.* at 3077.
154. *Id.* at 3076.
155. Barad & Layden, *supra* note 126, at 144.
156. *See de la Cuesta,* 121 Cal. App. 3d 328, 175 Cal. Rptr. 467 (Cal. Dist. Ct. App. 1981), *rev'd,* 458 U.S. 141 (1982).
157. Barad & Layden, *supra* note 126, at 146.
158. SENATE REPORT, *supra* note 98, at 3076; Wertheim, *supra* note 126, at 116.
159. SENATE REPORT, *supra* note 98, at 3078.
160. 12 C.F.R. § 591.4(c) (1984); Barad & Layden, *supra* note 126, at 144.
161. SENATE REPORT, *supra* note 98, at 3077.
162. *Id.*

the use of blended-interest rates.[163]

If state legislatures made window period loans permanently transferable, this might contravene the preemption rule set forth in section 341(b)(1) and "take back from the lenders that which the Act sought to give."[164] While states have the power to enact laws dealing with window period loans, they may not expand the type of loan governed by a window period.[165] If states take no action by October 14, 1985, federal preemption becomes effective and the due-on-sale clauses in window period loans will be enforceable.[166] In addition, lenders may call in the mortgage debt even in window period loans, where the buyer is unable to meet the lenders' credit requirements.[167]

The Garn Act sought to end the confusion in the mortgage market caused by state restrictions on the enforcement of due-on-sale clauses, but the window period exceptions, the ability of the states to expand these exceptions, and the different treatment afforded federal and non-federal institutions only create more confusion. The Garn Act preempts all state statutes, common law, and constitutional provisions; yet at the same time it recognizes these same state laws with respect to the window period exception. The Garn Act specifically allows states to legislate on the window period exception, and thereby to occupy a part of the field of law concerning due-on-sale clauses.

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163. Barad & Layden, *supra* note 126, at 144; *see also* Coleman, *Federal Preemption of State Law Prohibitions on the Exercise of Due-On-Sale Clauses,* 100 BANKING L.J. 772 (1983). Coleman noted that:

> Although this language appears on its face to be merely a bit of gratuitous advice to lenders to compromise with borrowers when negotiating the interest rate upon the transfer of a loan, it is conceivable that at some point a borrower may challenge a given lender's right to exercise a due-on-sale clause on the basis of this rather unusual statutory language.

Id. at 779. For an example of a state complying with the Garn Act's encouragement, see N.M. STAT. ANN. § 48-7-15C(2)-(3) (1983) (legislation authorizing a blended rate for window period loans until Oct. 15, 1982).

Blended rate interest is defined as "an interest rate between the lower contract rate and the higher market rate for newly originated loans." SENATE REPORT, *supra* note 98, at 3075.

164. Barad & Layden, *supra* note 126, at 144.

165. SENATE REPORT, *supra* note 98, at 3077. The report provides that "state legislatures may not expand the types of loans to which the window period applies—e.g. a state which presently restricts due-on-sale enforcement for single family loans . . . but not multifamily loans could not expand that restriction to multifamily loans." *Id.*

166. SENATE REPORT, *supra* note 98, at 3077 ("[i]f a state takes no action during the three year period the federal preemption would become effective thereafter and due-on-sale clauses in window period loans would be enforceable"). *See* Barad & Layden, *supra* note 126, at 144.

167. Barad & Layden, *supra* note 126, at 145; *see* 12 C.F.R. § 591.4(d) (1984) (rules governing determination of whether transfer of real property satisfies lender's customary credit standards).

D. The Act's Effect on Minnesota

The Senate Committee noted that four states had statutes restricting the enforcement of due-on-sale clauses[168] and that "Georgia and Minnesota also have adopted laws on the subject, but it is unclear from reading them just what restrictions, if any, they impose on the enforcement of due-on-sale clauses. The highest courts in those states could be the final arbiter of the impact of those laws."[169] One commentator found this language "puzzling" in light of the clear restrictions in Minnesota Statutes section 47.20, subdivision 6.[170] Nevertheless, subdivision 6 was amended in 1977,[171] 1979,[172] and 1981,[173] thus possibly creating three window periods. Minnesota Statutes section 47.20, subdivisions 6 and 6a,[174] is the only Minnesota statute applicable to due-on-sale clauses. The statute applies to certain loans of less than $100,000 made to non-corporate borrowers purchasing one to four unit residential property for use as the borrower's primary residence.[175] Subdivisions 6 and 6a apply to all lenders with the exceptions of federally-chartered savings and loan associations and national banks in mortgage transactions involving adjustable interest rates.[176] These two subdivisions do not apply to FHA and VA loans.[177]

The exact boundaries of the window period in Minnesota are uncertain. Since state statutes are one of the forms of state action that can trigger a window period,[178] one possibility is on or after April 1, 1976, when the legislature amended Minnesota Statutes section 47.20, subdivision 6.[179] This amendment limited the assumption fee for loans originating on or after April 1, 1976.[180] The limit on the assumption fee could restrict the exercise of a due-on-sale clause if the "assumption fee" lan-

168. SENATE REPORT, *supra* note 98, at 3076 n.2. The four states listed by the Senate Committee were Colorado, Iowa, New Mexico, and Utah. *Id.*

169. *Id.*

170. Wertheim, *supra* note 126, at 114.

171. Act of May 27, 1977, ch. 350, 1977 Minn. Laws 745, 749 (codified as amended at MINN. STAT. § 47.20 (1982)).

172. Act of Apr. 30, 1979, ch. 48, 1979 Minn. Laws 62, 63-64 (codified as amended at MINN. STAT. § 47.20 (1982)).

173. Act of May 8, 1981, ch. 137, 1981 Minn. Laws 420, 428-29 (codified as amended at MINN. STAT. § 47.20, subds. 6, 6a (1982)). This amendment added subdivision 6a. *Id.*

174. MINN. STAT. § 47.20, subd. 6a (1982).

175. *Id.* § 47.20, subd. 2(3) (1983) (defining "conventional loan" as used in subdivisions 6 and 6a); *Id.* § 47.20, subds. 6, 6a; Rom, *supra* note 129, at 9.

176. § 47.20, subd. 6a.

177. *Id.* § 47.20, subd. 2(3) (defining "conventional loan" as used in subdivisions 6 and 6a while excluding FHA and VA loans).

178. *See* SENATE REPORT, *supra* note 98, at 3076.

179. Act of Apr. 13, 1976, ch. 300, 1976 Minn. Laws 1117, 1121 (amending MINN. STAT. § 47.20, subd. 6 (1982)).

180. § 47.20, subd. 6.

guage were given a broad interpretation.[181] Since due-on-sale enforcement usually results in the buyer assuming the mortgage at a market interest rate, this increased interest rate could be construed as an "assumption fee." A more narrow reading would be that the 1976 amendment only restricts the assumption fee.[182] In any event, there is confusion as to whether this 1976 amendment creates a window period in Minnesota from April 1, 1976 to May 31, 1979.

Another window period may have been created by the 1979 amendment to Minnesota Statutes section 47.20, subdivision 6 which covers purchase money, residential, and conventional mortgages made between June 1, 1979 and May 8, 1981.[183] The statute requires that a mortgagee must consent to the transfer of the property as long as the seller continues to be obliged for the indebtedness.[184] The lender cannot increase the interest rates nor inquire into the creditworthiness of the purchaser.[185]

Another window period may have been judicially created by the Minnesota Supreme Court in its *Holiday Acres* decision. In *Holiday Acres,* the Minnesota Supreme Court interpreted, in dictum, section 47.20, subdivision 6.[186] The court stated that the legislature, by enacting the section, had in effect determined that the enforcement of due-on-sale clauses in the sale of owner-occupied residential property was unreasonable per se unless enforcement was necessary to protect the lender's security interest.[187] Since the Garn Act's legislative history states that the definition of the window period is left to state statutes, constitutional provisions, *or judicial decisions of the highest court in the state,*[188] subdivision 6 thus creates a window period for mortgages qualifying under the statute that originated on or after June 1, 1979 and on or before May 8, 1981.[189] Thus, these mortgages will have restricted due-on-sale clauses until October 15, 1985, unless the Minnesota Legislature enacts further legislation in this area.[190]

Subdivision 6a, added in 1981, governs mortgages coming under the

181. Wertheim, *supra* note 126, at 114-15 n.11. Wertheim argued that a limitation on an assumption fee also operates to limit the exercise of a due-on-sale clause. *Id.*

182. *Id.* Wertheim stated that if limited to restricting assumption fees, this amendment will create a window period governing assumption fees. *Id.*

183. § 47.20, subd. 6; *see also* Wertheim, *supra* note 126, at 114.

184. § 47.20, subd. 6; Rom, *supra* note 129, at 9.

185. § 47.20, subd. 6; Rom, *supra* note 129, at 9.

186. 308 N.W.2d 471, 484 (Minn. 1981).

187. *Id.*

188. SENATE REPORT, *supra* note 98, at 3076.

189. Rom, *supra* note 129, at 9; *see* Wertheim, *supra* note 126, at 114 (section 47.20, subd. 6 appears to prohibit exercise of due-on-sale clauses in purchase money residential conventional mortgages made between June 1, 1979 and May 8, 1981).

190. *See* SENATE REPORT, *supra* note 98, at 3077; *supra* notes 160-61 and accompanying text.

statute which were entered on or after May 9, 1981.[191] Subdivision 6a requires the lender to consent to the buyer's assumption and to release the seller from liability if the buyer is creditworthy and agrees to assume the obligations from the seller and to the increase of the interest rate.[192] Confusion surrounds the effect of the Garn Act on this amendment. While there is no prohibitory language in the statute, one commentator has concluded that it prohibits the enforcement of due-on-sale clauses in conventional loans.[193] Another has stated that the Act essentially makes due-on-sale clauses fully enforceable.[194]

Thus, out of three Minnesota statutes which could possibly create a window period, the 1976 and the 1981 amendments do not clearly create such a period and the 1979 amendment would be in a similar situation if the *Holiday Acres* court had not addressed the amendment in its decision. Determining whether Minnesota has statutorily created window periods is much less confusing, however, than determining whether Minnesota has a judicially created window period.

There is no Minnesota Supreme Court decision dealing with the enforceability of due-on-sale clauses prior to the *Holiday Acres*[195] decision of April 3, 1981. In *Holiday Acres,* the Minnesota Supreme Court stated that "the Legislature, by enacting Minn. Stat. § 47.20, subd. 6 . . . has determined, in effect, that the enforcement of due-on-sale clauses in the transfer of borrower-occupied residential property, as limited by the statute is *per se* unreasonable except to protect against impairment of the lender's security interest."[196] In determining whether *Holiday Acres* creates a window period, it is important to note that the court's language is dictum. The Minnesota Supreme Court, however, in *Gate Co. v. Midwest Federal*

191. Act of May 8, 1981, ch. 137, 1981 Minn. Laws 420, 428-29 (codified as amended at MINN. STAT. § 47.20, subd. 6a (1982)).

192. *Id.* Subdivision 6a provides in part:

> The lender may charge a fee not in excess of one-tenth of one percent of the remaining unpaid principal balance in the event the loan or advance of credit is assumed by the transferee and the existing borrower continues after the transfer to be obligated for repayment of the entire assumed indebtedness. A lender may charge a fee not in excess of one percent of the remaining unpaid principal balance in the event the remaining indebtedness is assumed by the transferee and the existing borrower is released from all obligations under the loan instruments.

Id.

193. Rom, *supra* note 129, at 9. Rom states:

> [T]here undoubtedly will be some disagreement as to [subdivision 6a's] effect under the Garn Bill. The most likely interpretation will be that since the statute essentially prohibits the enforcement of due-on-sale clauses in conventional loans, the Garn Bill would not preempt conventional loans made on or after May 9, 1981, which are transferred prior to October 15, 1985, and they are assumable.

Id.

194. Wertheim, *supra* note 126, at 114-15 (probable effect is to make due-on-sale clauses in residential mortgages entered into after May 8, 1981 fully enforceable).

195. 308 N.W.2d 471.

196. *Id.* at 484.

Savings & Loan Association,[197] referred to the language in *Holiday Acres* as a holding, not dictum.[198] In *Hoeg v. Twin City Federal Savings & Loan Association*[199] the court stated, "The trial court, relying on our decision in *Holiday Acres* . . . properly concluded that the due on sale clause was unenforceable."[200] One commentator has stated that the dicta in *Holiday Acres, Gate,* and *Hoeg* is "weak—it does not purport to be a decision of the court, but only a characterization of Minnesota Statute[s] [section] 47.20, subd. 6 or 6a."[201]

Even if *Holiday Acres* is interpreted to create a window period, some mortgages on residential owner-occupied property will be subject to statutory regulation. Residential mortgages made on or after April 3 to May 8, 1981 will be subject to the window period created by Minnesota Statutes section 47.20, subdivision 6. In addition, most residential mortgages entered into on or after May 8, 1981 to October 15, 1982 will be subject to subdivision 6a,[202] which may create a window period. The only post-April 3, 1981 borrower-occupied mortgages which would definitely come under a judicial window period are refinanced mortgages or mortgages over $100,000, neither of which are subject to statutory regulation.[203]

Arguably, the Garn Act leaves the ultimate determination of a judicial window period to the Minnesota Supreme Court. Armed with such power, the court in *Viereck v. Peoples Savings & Loan Association*[204] elevated its *Holiday Acres* dictum to the status of a holding.[205]

In Minnesota, the Garn Act created more confusion than it eliminated. The window period exception is not easily discerned from vague

197. 324 N.W.2d 202 (Minn. 1982).

198. *Id.* at 205. The court stated:

> The trial court, relying on our holding in *Holiday Acres* . . . concluded that [the lender] had no right to enforce the clause because Minnesota law prohibits the exercise of such clauses in mortgages covering owner-occupied residential property. In *Holiday Acres,* we noted that under Minnesota Law the enforcement of due-on-sale clauses in the transfer of borrow-occupied residential property is *per se* unreasonable unless done to protect the lender from the impairment of its security interest.

Id.

199. 324 N.W.2d 377 (Minn. 1982).

200. *Id.* at 377. *Gate Co.* and *Hoeg* were decided on federal preemption grounds, not on the direct issue of enforcement of due-on-sale clauses in mortgages to which the preemption is inapplicable. *See Gate Co.,* 324 N.W.2d at 205-07; *Hoeg,* 324 N.W.2d at 377-78; Rom, *supra* note 129, at 10.

201. Rom, *supra* note 129, at 10. Rom argues that the court's "characterization of the statute is clearly in error, since there are many mortgages of owner-occupied property not covered by the statute." *Id.*

202. MINN. STAT. § 47.20, subd. (6)(a) (1982).

203. *See id.* Since *Holiday Acres* was decided on April 3, 1981, it can create a judiciary window period only for mortgages covered after that date and those that do not meet the statutory requirements of origination and a principal amount of less than $100,000. *See* Rom, *supra* note 129, at 9.

204. 343 N.W.2d 30 (Minn. 1984).

205. *See infra* note 286 and accompanying text.

state statutes and judicial dicta. To clarify the Garn Act and its impact on state law, the Bank Board promulgated regulations on May 13, 1983 which take a firmer pro-lender stance than the Garn Act.[206]

IV. THE 1983 REGULATIONS AND THEIR EFFECT ON MINNESOTA MORTGAGES

On May 13, 1983, the Bank Board promulgated its final regulations governing the implementation of the Garn Act in an attempt to clarify problems created by the Act.[207] These regulations (1983 Regulations) restate and clarify some statutory provisions of the Garn Act.[208] Many questions facing Minnesota practitioners after the Garn Act are addressed by the 1983 Regulations.[209] Indeed, some of the provisions seem tailored to areas of Minnesota due-on-sale law left uncertain after enactment of the Garn Act.[210] The 1983 Regulations, however, are overwhelmingly pro-lender and were soon attacked by the Minnesota Supreme Court in *Viereck v. Peoples Saving & Loan Association.*[211]

The 1983 Regulations explicitly provide that the identity of the mortgage originator, rather than the holder, determines whether the loan is subject to a window period.[212] Therefore, only those mortgages originating from non-federal savings and loans are eligible for window period protection.[213]

The 1983 Regulations modify the statutory scheme of the Garn Act by

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206. 48 Fed. Reg. 21,554-63 (1983) (amending 12 C.F.R. §§ 556.9, 590.2(g), 590.4(e), adding part 591 (1984)).

207. *Id.; see also* 12 U.S.C.A. § 1701j-3(e)(1) (West Supp. 1983). This section provides: "The Federal Home Loan Bank Board, in consultation with the Comptroller of the Currency and the National Credit Union Administration Board, is authorized to issue rules and regulations and to publish interpretations governing the implementation of this section." *Id.*

208. *See* Wertheim, *New Due-On-Sale Regulations,* 1 MINN. REAL EST. L.J. 181 (1983).

209. *See id.*

210. *Id.* at 181.

211. 343 N.W.2d 30 (Minn. 1984).

212. *See* SENATE REPORT, *supra* note 98, at 3078. The report provides:

> The identity of the lender at the time the loan was originated determines whether or not a loan is subject to window period restrictions. For example, a loan originated by a state chartered savings and loan association which subsequently converted to a federally chartered thrift will be subject to state due-on-sale restrictions for three years, unless state action provides other treatment for such loans.

Id.

213. 12 U.S.C.A. § 1701j-3(b)(3) (West Supp. 1983); *see* Wertheim, *supra* note 208, at 182; Barad & Layden, *supra* note 126, at 146; *see also* 48 Fed. Reg. 21,554, 21,562 (1983) (to be codified at 12 C.F.R. § 591.3(b)). This regulation provides that the "exercise by any lender of a due-on-sale clause in a loan originated by a Federal association shall be exclusively governed by the terms of the loan contract, and all rights and remedies . . . shall at all times be fixed and governed by that contract." *Id.*

restricting the window period and other exemptions.[214] Only loans made on owner-occupied homes are covered by a window period; loans issued for commercial development, for example, are not covered.[215]

This pro-lender approach is followed with regard to "blended rates." The statutory language merely encourages a lender to allow a consumer to assume a blended rate mortgage;[216] no lender, however, is obligated to average the contract and market rates.[217] The 1983 Regulations stressed a plain language reading of the Garn Act and imposed no mandatory obligation on lenders to adopt a blended rate policy.[218]

The 1983 Regulations address the issue whether contracts for deed come within the scope of the Garn Act. While the Garn Act did not specifically include contracts for deed in its definition of a loan secured by a lien on real property,[219] the 1983 Regulations plainly expand the definition of a loan to include contracts for deed.[220]

The 1983 Regulations also address the issue whether a contract for deed is a subordinate lien. The regulations indicate that the creation of a vendee's or vendor's interest in a contract for deed is not included in the window period exception.[221] The 1983 Regulations state that the window period exception applies "[p]rovided [t]hat such lien or encumbrance is not created pursuant to a contract for deed."[222] The Bank Board added this language to close a loophole in the subordinate lien exception for transfer of an equitable interest to a vendee by a contract for deed.[223] The Bank Board took the liberty of adding language to the Act because otherwise the loophole would have made the Act

214. 12 C.F.R. § 591.5 (1984).

215. Barad & Layden, *supra* note 126, at 149 (permitted transfers only apply to loans made on owner-occupied homes; therefore, loans for construction and development would not be covered by a window period).

216. 12 U.S.C.A. § 1701j-3(b)(3) (West Supp. 1983). For a definition of "blended rate" mortgage, see *supra* note 163 and accompanying text.

217. *See* Coleman, *supra* note 163, at 779-80 and accompanying text (the National Association of Realtors urged lenders and borrowers to compromise on a blended rate of interest between contract and market rates upon transfers of unencumbered property).

218. Supplementary Information: Preemption—Other Lenders, 48 Fed. Reg. 21,554, 21,558 (1983) (a lender has no mandatory obligation to offer blended rates); *see* 12 U.S.C.A. § 1701j-3(b)(3) (West Supp. 1983).

219. *See* Rom, *supra* note 129, at 8 (the Garn Act does not specify whether it applies to contracts for deed); *cf.* Karem v. Werner, 333 N.W.2d 877 (Minn. 1983) (court enforced a due-on-sale provision in an action to enjoin vendors from proceeding with a cancellation of contract for deed, rendering the issue of whether the Garn Act applied to contracts for deed moot). *Id.* at 878 n.1.

220. 12 C.F.R. § 591.2(h) (1984). This definition includes "a loan on the security of any instrument (whether a mortgage, deed of trust, or land contract)." *Id.*

221. *Id.* § 591.5(b) (1984).

222. *Id.* § 591.5(b)(1)(i) (1984); *see* Wertheim, *supra* note 208, at 183 (language excluding liens created pursuant to a contract for deed was added to avoid possible loopholes in the transfer of an equitable interest to a vendee by a contract for deed).

223. *See* 12 C.F.R. § 591.5 (1984).

meaningless.[224]

This regulatory addition also answers the question whether the transfer of a vendor's interest in a contract for deed creates a subordinate lien. This issue was left unresolved by the Minnesota Supreme Court in *Gate Co.*[225] The comments to the final regulation indicate that the exception does not apply to either a vendor's or a vendee's interest in a contract for deed.[226] This regulation is contrary to Minnesota law which classifies a vendor's interest as a lien.[227] In addition, it sets a trap for the unsophisticated vendee who does not restrict the rights of his vendor to assign the contract.[228]

The protection afforded by a state statutory window period is further restricted by the 1983 Regulations' definition of statutes which create window periods.[229] The 1983 Regulations set forth two specific categories of state statutes which can create window periods.[230] To be eligible, the statute must: (1) restrict the lender's right to enforce the due-on-sale clause to instances in which the lender's security would be impaired; or (2) restrict the lender's right to increase the interest rate on the transfer.[231] These categories are exclusive; statutes failing to fulfill one of these criteria do not create window periods.[232] A statute providing that the mortgagor has an extended period of redemption after a foreclosure sale based on the enforcement of a due-on-sale clause falls outside these categories and does not create a window period.[233] A statute which merely limits the fees a lender may charge upon transfer also fails to create a window period.[234]

Under the 1983 Regulations, the current version of Minnesota Statutes section 47.20, subdivision 6, which requires lender consent on residential mortgage transfers made between June 1, 1979 to May 8, 1981,[235] creates a window period.[236] However, a current version of that same statute

224. *Id.*

225. *See Gate Co.,* 324 N.W.2d at 205. Some courts previously facing the issue concluded that a sale by contract for deed was not exempted. *E.g.,* Williams v. First Fed. Sav. & Loan Ass'n, 651 F.2d 910, 920-21 (4th Cir. 1981); Smith v. Frontier Fed. Sav. & Loan Ass'n, 649 P.2d 536, 538 (Okla. 1982).

226. Wertheim, *supra* note 208, at 183-84; *see* 12 C.F.R. § 591.5(b)(1)(i) (1984).

227. Wertheim, *supra* note 208, at 184; *see supra* note 137 and accompanying text.

228. Wertheim, *supra* note 208, at 184, *citing* Wertheim, *Due-on-Sale Clauses in Minnesota,* 1 MINN. REAL EST. L.J. 33, 40 (1982); Wertheim, *Due-on-Sale Clauses—An Update,* 1 MINN. REAL EST. L.J. 81, 84-86 (1982).

229. Wertheim, *supra* note 208, at 182.

230. 12 C.F.R. § 591.2(p)(3) (1984); 12 C.F.R. § 591.2(p)(2)(i) (1984).

231. Wertheim, *supra* note 208, at 182 n.19.

232. *Id.* at 182-83, *citing* 48 Fed. Reg. 21,554, 21,555-56 (1983).

233. 48 Fed. Reg. 21,554, 21,556 (1983).

234. *Id.*

235. MINN. STAT. § 47.20, subd. 6 (1982).

236. *See* 12 C.F.R. § 591.2(p)(3) (1984); *see also* Wertheim, *supra* note 208, at 182-83. Wertheim states that the 1983 Regulations restrict the categories of state laws that will

which limited the assumption fees charged for residential home loans made from April 1, 1976 to May 31, 1979[237] would not create a window period.[238]

In addition to restricting the categories of state statutes that afford window period protection, the 1983 Regulations took notice of some state statutes that restricted enforcement of certain types of mortgages.[239] Under the Regulations, the 1983 window periods only create protection for loans specifically addressed by state law.[240] Minnesota's statutory window period, therefore, applies only to loans of less than $100,000 secured by a mortgage on a one- to four-unit borrower-occupied dwelling.[241]

While the Garn Act impliedly allows states to enact legislation to create a statutory window period,[242] the 1983 Regulations limit the actions a state may take. The Senate Report suggested that states may repeal the due-on-sale restrictions, extend the time the restrictions apply, or authorize the use of a blended interest rate.[243] The 1983 Regulations, however, only allow the states to either eliminate existing due-on-sale restrictions or shorten the three-year transition period from October 15, 1982 to October 15, 1985.[244]

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qualify under the Regulations. The categories are exclusive; if a state does not fall within one of the categories, no window period will be created. *See id.*

237. § 47.20, subd. 6.

238. *See* Wertheim, *supra* note 208, at 182-83; *see also supra* note 236.

239. Wertheim, *supra* note 208, at 183.

240. *See* 12 C.F.R. § 591.2(p)(1) (1984). A window period loan under section 591.2 (p)(1) applies only to real property loans which were "made or assumed during a window-period created by state law and subject to that law." *Id.*

241. *See* § 47.20, subd. 6. Subdivision 6, the statute creating Minnesota's window period, applies only to conventional loans for the purchase of any one to four family dwelling that will be used as a borrower's primary residence. *Id.* A "conventional loan" is defined as "a loan or advance of credit . . . to a noncorporate borrower in an original principal amount of less than $100,000, secured by a mortgage upon real property containing one or more residential units." § 47.20, subd. 2(3). Therefore, the window period applies only to those loans of less than $100,000 that are secured by a mortgage on a one to four unit, borrower-occupied dwelling.

242. *See* SENATE REPORT, *supra* note 98, at 3077. Under the Garn Act, window period loans originated by non-federally chartered lenders are subject to state law for three years, unless the state acts within that time period to regulate these loans in a different fashion. The three-year period, which began after the enactment of the Garn Act:

> provide[d] State Legislatures . . . with the opportunity to review the impact due-on-sale restrictions have imposed on non-federally chartered lenders, [to] consider the rights of consumers who received assumable mortgages under state laws or court decisions restricting due-on-sale enforcement, and to formulate an alternative approach to window period loans if . . . desire[d].

Id.

243. *Id.*

244. Supplementary Information: Preemption—Other Lenders, 48 Fed. Reg. 21,554, 21,558 (1983). The Federal Home Loan Bank Board has interpreted 12 C.F.R. § 591.4(c)(1)(A) (1984) to allow states to shorten the three-year transition period, or even

The Federal Home Loan Bank Board interpretation of the 1983 Regulations addresses the issue of judicially-created window periods.[245] Under the Board's interpretation, a state judicial decision creating window period protection must "include language expressly holding a due-on-sale clause unenforceable, rather than merely commenting on unenforceability in *dicta.*"[246] Minnesota, therefore, does not have a common law window period, because the *Holiday Acres* language on the enforcement of a due-on-sale clause is dictum.[247] Although the language in *Gate Co.* appears to elevate the *Holiday Acres* language to a holding,[248] the original language of *Holiday Acres* and *Gate Co.* is dictum.[249] Thus, neither case creates a judicial window period.

By interpreting the Garn Act in a pro-lender manner, the 1983 Regulations further erode the power of consumer mortgagors which was already limited by *de la Cuesta* and the Garn Act. One commentator has argued that the 1983 Regulations are "vulnerable to judicial challenge."[250] Another, however, has pointed out that a challenge to the 1983 Regulations would not be promising given the deference shown to the previous due-on-sale regulations by the United States Supreme Court in *de la Cuesta.*[251] The Minnesota Supreme Court decided *Viereck* against the background of this pro-lender approach of the Supreme Court, the Congress, and the Bank Board.

V. THE *VIERECK* CASE

A. Facts

The *Viereck* decision encompasses two cases in which separate trial judges held that due-on-sale clauses, executed before June 1, 1979, on borrower-occupied residential property were unenforceable absent a credit risk to the mortgagee's security interest.[252] The first case involved the Viericks, who entered into a mortgage with Peoples Savings and

repeal an existing due-on-sale restriction. However, the state may not retroactively extend the window period, or expand the types of loans to which the window period applies. *Id.*

245. 12 C.F.R. § 591.2(p)(2) (1984).

246. *Id.*

247. *See Holiday Acres,* 308 N.W.2d at 480-84; *supra* notes 196-201 and accompanying text. The court in *Holiday Acres* specifically considered the effect of due-on-sale clauses only with respect to residential property held for investment. *Id.* at 484. While the court did discuss the general effect of due-on-sale clauses on borrower-occupied residential property, *id.* at 482-83, it did not apply that discussion to the decision in *Holiday Acres. Id.* at 484. This fact makes the discussion of due-on-sale clauses involving borrower-occupied residential property dicta.

248. *See Gate Co.,* 324 N.W.2d at 206-07; *supra* note 198 and accompanying text.

249. *See* Rom, *supra* note 129, at 10; *supra* notes 196-201 and accompanying text.

250. Geier, *Due-On-Sale Clauses Under the Garn-St. Germain Depository Institutions Act of 1982,* 17 U.S.F.L. REV. 355, 429 (1983).

251. Wertheim, *supra* note 208, at 181.

252. Viereck v. Peoples Sav. & Loan Ass'n, 343 N.W.2d 30 (Minn. 1984).

Loan Association (Peoples) on July 12, 1978 when they purchased their house.[253] The mortgage instrument was a uniform FNMA/FHLMC form[254] and contained a standard due-on-sale clause.[255] At the time of origination, Peoples was a state-chartered institution. On May 3, 1982, however, Peoples became federally-chartered.[256]

In 1980, the Vierecks purchased a new home and attempted to sell their old home on a contract for deed.[257] Peoples told the Vierecks that it would exercise the due-on-sale clause and accelerate payment of the balance due.[258] When the Vierecks discovered they could not close the sale if the Peoples' mortgage was unassumable, they were forced to rent out the property and brought a declaratory judgment action to determine whether the due-on-sale clause was enforceable.[259] The trial court found the clause unenforceable absent a risk to Peoples' security interest or an increased credit risk.[260]

The second case involved the Hueys, who mortgaged their owner-occupied residential property to Knutson Mortgage and Financial Corporation (Knutson), a state-chartered lending institution.[261] The Hueys' mortgage was also on a uniform FNMA/FHLMC form containing a due-on-sale clause.[262] A few weeks after the Hueys' mortgage was executed, Knutson assigned the mortgage to First State Federal Savings and Loan Association (First State), a federally-chartered institution.[263] In December 1979, the Hueys contacted First State requesting permission to sell their house on a contract for deed without refinancing the original loan.[264] First State said that it would exercise the due-on-sale clause.[265] The property was sold prior to October 15, 1982,[266] and the Hueys brought an action for summary judgment against the mortgagee.[267] The trial court, like the *Viereck* trial court, held the clause unenforceable unless the lender's security interest was at risk.[268]

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253. *Id.* at 32.

254. The mortgage instrument was a uniform instrument developed by the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC). *Id.* at 32 n.1.

255. *Id.* at 32.

256. *Id.* at 33.

257. *Id.* at 32.

258. *Id.*

259. *Id.*

260. *Id.*

261. *Id.* at 32-33.

262. *Id.*

263. *Id.* at 33.

264. *Id.*

265. *See id.*

266. *See* Wertheim, *Due-On-Sale Case Comment: Retroactivity of the Garn Act,* 2 MINN. REAL EST. L.J. 13, 14 (1984).

267. 343 N.W.2d at 33.

268. *Id.* The trial court concluded that federal law, which generally enforces due-on-

B. The Court's Decision

On appeal, Peoples and First State argued that the Garn Act and Bank Board regulations preempted Minnesota law governing the exercise of a due-on-sale clause in a mortgage executed prior to June 1, 1979.[269] Pursuant to the Garn Act, the lenders asserted that the Minnesota window period only covered loans originating on or after June 1, 1979, and before May 9, 1981.[270] Therefore, because the mortgage before the court was executed prior to June 1, 1979, Peoples and First State argued that the Garn Act and the Bank Board regulations allowed enforcement of the due-on-sale clause.[271] Despite the fact that the lending institutions were state-chartered when the mortgages originated, the lenders also relied on *de la Cuesta,* which held that federally-chartered institutions could exercise the due-on-sale clause under the federal regulations.[272]

The Minnesota court found the appellants' reliance on *de la Cuesta* "misplaced."[273] The court reasoned that *de la Cuesta* and the 1976 Bank Board regulations did not apply to mortgages originated by state-chartered institutions.[274] The court held that a mortgage originated by a state lending institution was not subject to the preemptive 1983 Regulations and the Garn Act merely because the mortgage was assigned to a federal institution or because the state lending institution converted to a federal association.[275]

By acknowledging the window period, the court recognized the need to ensure that mortgagors who had executed their loans prior to the Garn Act enactment date of October 15, 1982, in reliance on state law restricting enforcement of due-on-sale clauses, would be protected during the transition period between October 15, 1982 and October 15, 1985.[276]

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sale clauses, did not preempt state law in this case because the mortgage was executed before June 1, 1979. Minnesota common law considered due-on-sale clauses on borrower-occupied residences unenforceable as an unreasonable restraint on alienation. *Id.*

269. *Id.*

270. *Id.* at 34. The lenders contended that until the enactment of subdivision 6 of Minnesota Statutes section 47.20, Minnesota law was silent as to the enforcement of due-on-sale clauses. *Id.* at 34 n.4.

271. *See id.* In other words, the restriction against due-on-sale clauses applied only to mortgages originating during the window period. *Id.*

272. *Id.* at 33.

273. *Id.* at 33-34.

274. *Id.* at 33. *See generally* Williams v. First Fed. Sav. & Loan Ass'n, 651 F.2d 910, 922-23 (4th Cir. 1981); Bleecker Assoc. v. Astoria Fed. Sav. & Loan Ass'n, 544 F. Supp. 794, 797-99 (S.D.N.Y. 1982); Comment, *supra* note 121, at 913 (impairment of contractual rights is a tenuous argument because the Garn Act and *de la Cuesta* enforce rather than impair literal terms of mortgage contracts).

275. *See* Wertheim, *supra* note 266, at 13; *see also id.* at 13 n.2 (noting that the Federal Home Loan Bank Board has disclaimed authority to regulate mortgages not originated by federal associations).

276. *Viereck,* 343 N.W.2d at 34.

The court concluded that a contrary decision would allow a state-chartered institution to circumvent this policy by merely acquiring a federal charter or assigning loans to federal institutions.[277]

The court then addressed the Garn Act and found that neither the Act nor the 1983 Regulations could be applied retroactively.[278] This conclusion was based on the court's finding that the Garn Act did not contain a clear expression of retroactive intent.[279] In addition, the court noted that Congress had recognized that state law would apply in some cases under a window period exemption.[280] Examining the Garn Act, the court found no provision allowing retroactive application of the federal preemption provision. Therefore, the appellants could not accelerate the payment of mortgage balances when the mortgagors seek to transfer the mortgage on borrower-occupied residential property.[281]

The court reiterated its *Holiday Acres* dicta that lenders and mortgagors do not have equal bargaining power in a borrower-occupied residential mortgage transaction.[282] The acceleration of a mortgage or the imposition of a substantially higher interest rate imposes a penalty on a mortgagor and adversely restricts his opportunity to sell his property.[283] He must often sell as a result of a new job or job transfer,[284] and the enforcement of a due-on-sale clause on borrower-occupied residential property amounts to a restraint on alienation.[285] Therefore, the *Viereck* court transformed its *Holiday Acres* dicta, criticized in *de la Cuesta,* into a holding.[286]

C. Analysis

The *Viereck* court's holding that mortgages originated or transferred prior to June 1, 1979 are not preempted by the Garn Act and the federal regulations is confusing. The *Viereck* court examined the Garn Act only for express language of retroactive preemption.[287] While statutes gener-

277. *Id.* at 34; *see also Williams,* 651 F.2d at 922; *Bleecker Assoc.,* 544 F. Supp. at 798-99.

278. *See Viereck,* 343 N.W.2d at 34; *cf.* United States v. Security Indus. Bank, 459 U.S. 70, 79 (1982).

279. *Viereck,* 343 N.W.2d at 34. "Absent [a provision providing for retroactive application], the preemption provisions of the Garn Act apply to loans originated or transferred after October 15, 1982, the effective date of the act." *Id.*

280. *Id.* at 34. The court did not determine when the Minnesota window period commences and expires, nor did it hold that the Viereck mortgage was a window period mortgage. *Id.* at 35 n.5.

281. *Id.* at 34-35. *See generally* Wertheim, *supra* note 266, at 13.

282. 343 N.W.2d at 35 (citing *Holiday Acres,* 308 N.W.2d at 482).

283. *Id.* (citing *Holiday Acres,* 308 N.W.2d at 481).

284. *Id.* (citing *Holiday Acres,* 308 N.W.2d at 482).

285. *Id.* (citing *Holiday Acres,* 308 N.W.2d at 482-84); *see also* Volkmer, *The Application of the Restraints on Alienation Doctrine to Real Property Security Interests,* 58 IOWA L. REV. 747, 773-74 (1973).

286. *See* 343 N.W.2d at 36; Wertheim, *supra* note 266, at 13.

287. *See* 343 N.W.2d 30, 34-35.

ally have a prospective effect, a statute can operate retroactively if Congress' intent to impose a retroactive effect is expressly stated[288] or clearly shown by necessary implication.[289] The court did not analyze the necessary implications of the Garn Act's language. Although the Garn Act does not specifically state that all mortgages executed prior to the Act are not covered by a window period exception, and therefore contain enforceable due-on-sale clauses, such a provision can be implied. Section 341(b)(1) provides, "Notwithstanding any provision of the Constitution or laws (including the judicial decisions) of any State to the contrary, a lender may, subject to subsection (c), of this section enter into or enforce any contract containing a due-on-sale clause with respect to a real property loan."[290] Section 341(c)(1) creates the window period exception which appears to cover a time period prior to the enactment of the Garn Act.[291] Therefore, by implication the Garn Act must apply retroactively. If it did not, there would be no need to carve out a window period exception, since all mortgages originated or assumed before October 15, 1982 would be unaffected by the Garn Act.[292] In essence, Congress would not have granted window period protection to mortgages originated or transferred in the past if the Garn Act was not intended to apply retroactively.

The legislative history underlying the Garn Act also supports this interpretation.[293] Congress found compelling reasons to allow lenders to update existing mortgages.[294] This policy would be thwarted if the Garn Act had only a prospective effect for outstanding mortgages held by lenders on the date the Act was enacted.

In addition, an exclusively prospective effect would not satisfy congressional concerns in the secondary mortgage market.[295] State-chartered savings and loan associations face large financial losses arising from state restrictions on the enforcement of due-on-sale clauses. These losses

288. Fullerton-Krueger Lumber Co. v. Northern Pac. Ry., 266 U.S. 435, 437 (1925).

289. United States v. St. Louis, S. F. & Tex. Ry. Co., 270 U.S. 1, 3 (1926).

290. Title IV, § 341(b)(1), 96 Stat. 1505 (1982) (codified as amended at 12 U.S.C.A. § 1701j-3(b)(1) (West Supp. 1983)).

291. *Id.* § 341(c)(1). *See generally* SENATE REPORT, *supra* note 98.

292. *See* Wertheim, *supra* note 266, at 14 ("If the Garn act did not intend to reach any mortgages originated prior to October 15, 1982, absolutely no purpose was served by carving out a window period based on state law restrictions for only certain mortgages originated or assumed prior to October 15, 1982.").

293. *See* 128 CONG. REC. S12,212-64 (daily ed. Sept. 24, 1982) (statement of Sen. Garn). Senator Garn stated, "Section 341 of the bill will not affect state personal property rights, state securities statutes, or state foreclosure laws as long as they are not used to inhibit or obstruct the Congressional purpose of allowing lenders to enforce due-on-sale clauses in real property loans." *Id.* at S12,235.

294. *See* SENATE REPORT, *supra* note 98; TASK FORCE, *supra* note 100.

295. *See generally* Note, *supra* note 121 and accompanying text (the primary concern is that unenforceable due-on-sale clauses would render loans less marketable in secondary markets since loans could not be refinanced at current interest levels).

would not be alleviated if the Garn Act did not apply retroactively.[296]

The primary legislative policy of strengthening home lending institutions cannot be realized unless the Garn Act applies retroactively.[297] The Minnesota Supreme Court's holding that mortgages originating before June 1, 1979 are not affected by the Garn Act contravenes the Act and the 1983 Regulations' purpose of validating all due-on-sale clauses with the exception of those falling within window periods.[298]

In concluding that the Garn Act does not apply retroactively to mortgages executed prior to June 1, 1979, the *Viereck* court relied on the policies underlying the window period exception. The court, however, failed to establish the dates of the Minnesota window period and whether the Vierecks' or the Hueys' mortgages fell within a window period.[299] Although defining a window period for Minnesota was clearly within the court's power,[300] it declined to make that determination.[301] A clear determination of the Minnesota window period would have added certainty to Minnesota mortgage law for the transitional period ending on October 15, 1985.

Instead of following the policies set forth by *de la Cuesta,* the Garn Act and the 1983 Regulations, the Minnesota court went to extremes to protect Minnesota homeowners by erroneously applying Minnesota law to hold that the Garn Act and the Regulations do not apply to a non-federally originated pre-October 15, 1982 mortgage. In *Viereck,* the court brought its *Holiday Acres* dicta back to life in the form of a holding which strongly voices support for pro-consumer mortgagor law.[302] The Minnesota Supreme Court must have been aware that the issue would be moot by October 15, 1985, before there would be a chance to appeal the *Viereck* decision. The court, therefore, continued its pro-mortgagor policy voiced in earlier decisions.[303]

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296. *See* CONG. REC. S12,213 (daily ed. Sept. 24, 1982) (statement of Rep. Riegle).

297. *See generally* SENATE REPORT, *supra* note 98; TASK FORCE, *supra* note 100.

298. *See* Wertheim, *supra* note 264, at 14 ("The basic purpose of the Garn Act was to validate due-on-sale clauses across the board except where pre-Garn expectations based on window periods were to be respected.").

299. *See* 343 N.W.2d 30, 35 (court noted that both parties argued extensively about when the window period begins and ends in Minnesota, court did not provide an answer to that issue); Wertheim, *supra* note 266, at 13 ("The Minnesota court declined to decide whether the two pre-June 1, 1979, mortgages were subject to a window period exception. Rather, the court held that the Garn Act did not apply retroactively to the two mortgages").

300. *See* SENATE REPORT, *supra* note 98, at 3076-78.

301. *See* 343 N.W.2d at 35 n.5.

302. *Id.* at 35-36.

303. *See generally* Cross Co., Inc. v. Citizens Mortgage Inv. Trust, 305 Minn. 111, 232 N.W.2d 114 (1975) (after mortgagee purchased property at foreclosure sale, it was not entitled to possession or rents during statutory redemption period despite mortgagor's assignment of lease to mortgagee); Gandrud v. Hansen, 210 Minn. 125, 297 N.W. 730, 733-34 (1941) (mortgagor may dispose of his equity in mortgaged property when and as he

As a result of *Viereck,* Minnesota homeowners will be able to transfer non-federally originated loans created before October 15, 1982 without worry that the due-on-sale clauses will be exercised.[304] Minnesota realtors, home sellers, and home buyers would be at a great advantage to transfer mortgages qualifying under *Viereck* before October 15, 1985.[305] According to *Viereck,* Minnesota lenders must permit transfers of mortgages qualifying under *Viereck* without exercising their due-on-sale clauses.[306] Therefore, prior to October 15, 1985, home owners can sell their houses with mortgages meeting the *Viereck* standards without decreasing the selling price to compensate for mortgage refinancing. Likewise, home buyers can purchase those homes without refinancing at a high current interest rate. *Viereck* greatly boosts the Minnesota real estate market, yet disadvantages the lending institutions who must continue to hold *Viereck* mortgages with below market interest rates.

VI. CONCLUSION

In *Viereck,* the Minnesota Supreme Court reacted to the steady pro-mortgagee trend embodied in *de la Cuesta,* the Garn Act, and the 1983 Regulations by making a last stand for the occupying homeowner-mortgagor. While the holding that non-federally originated residential mortgages created prior to October 15, 1982 may be transferred without enforcement of due-on-sale clauses has great impact on the Minnesota real estate market and on affected lending institutions, the impact is short-lived. The *Viereck* decision which reinstated the pro-mortgagor *Holiday Acres* stance will be moot on October 15, 1985.

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pleases); Twenty Assocs., Inc. v. First Nat'l Bank & Trust Co., 200 Minn. 211, 273 N.W. 696, 698 (1937) (mortgagor may not, as part of a mortgage transaction, bargain away his equity of redemption; any attempt to do so will not be enforced by a court of equity); Sanderson v. Engel, 182 Minn. 256, 234 N.W. 450, 451 (1931) (mortgagor's right to redeem cannot be extinguished by agreement made at time of the transaction); Niggeler v. Maurin, 34 Minn. 118, 24 N.W. 369 (1885) (in doubtful cases a land transaction will generally be construed as a mortgage rather than a conditional sale to save forfeiture).

304. *Viereck,* 343 N.W.2d 30, 34.

305. *Id.* at 34-35.

306. *Id.*